Constellation: Management Report 2Q14

Long Only Performance	Fund	Ibovespa in USD
YTD:	+ 10.50%	+ 10.15%
Last 12 months:	+ 7.71%	+ 12.72%
Annualized Return since inception:	+ 19.66%	+ 5.90%

Long Short Performance	Fund
YTD:	+ 6.68%
Last 12 months:	+ 4.12%
Annualized Return since inception:	+ 8.66%

Dear Investors,

In this last quarter we saw a reversion of the pessimism shown towards Emerging Markets and Brazil specifically. On the quarter, Brazil had a positive return in BRL of 5.46% and, with currency appreciation, the return was +8%. Hence, the assets appreciated both nominally and due to favorable currency fluctuations. Both mainly supported by international investors' inflows.

Although the whole Emerging Markets recovered value, we can account part of this appreciation to the political scenario in Brazil. The political situation has been dominating most debates around investment scenarios. Until recently, the base case was that our president, Dilma, was going to be reelected. However, recent political pools are indicating that the opposition's chances are growing, which is a scenario more welcomed by the market and business owners. Nowadays, political analysts are projecting that the opposition has close to a 50% winning chance, undoubtedly a much better scenario.

It is not part of our DNA to make changes in our portfolio based on election polls. Our businesses share a common characteristic of being less affected by changes in Government than SOEs (State Owned Enterprises), which lead us to conclude that during these volatile periods (elections), we understand that there is a strong possibility to see our companies underperforming on the short term since the index carries a high weighting on SOEs.

Even though our companies are less dependent on the Government, if the opposition wins the election, it should create a positive impact on the business environment. We should expect more investments to be unlocked given less political uncertainty and a more friendly approach by the authorities in comparison to the current Government. This scenario would obviously be better for our companies and their valuations since they have been suffering from long term high interest rates and low growth expectations .

In a scenario of a change in Government, we expect 2015 to be a year of adjustments in policies and structural reforms. This will probably have a negative impact in growth and/or inflation in the short term, but this should open a very positive expectation for the coming years given that one of the main reasons why Brazil has been growing below potential is that the current Government avoided addressing the much needed reforms.

Performance

In the second quarter the fund was up 9.21% in BRL and 11.63% in USD. The returns ytd are respectively 4,35% in BRL and 10,50% in USD.

There were not relevant detractors during the period. The main contributors for the positive performance were: Kroton, Abril and Anheuser-Bush Inbev. The only 2 positions in the portfolio that did not have a good performance were Gerdau and Lopes. In both cases, our analysis indicates that the returns are being affected more by circumstantial reasons than structural ones. We continue to believe that the earnings power generation is preserved and we remain confident to keep those investments in the portfolio.

One of our investments that is not on the above list but is also producing good returns is Embraer. We now have been invested in the company for 1 year and we would like to use this opportunity to detail our investment thesis.

Embraer's investment case

Embraer has been in our investment spotlight for several years now, given its unique position as one of the most technologically advanced companies in Brazil, putting it in the same playing field as renowned international companies. Since last year we gradually started to increase our investment in the company as we gained more conviction in its strategy, its management and their ability to successfully navigate in the aerospace market, achieving leadership in the segments in which they operate.

Embraer's business model is centered on a distinguished capacity in systems integration, project development, strategic planning of product portfolio and partnerships with key suppliers and regional governments. As such, Embraer has seen growing market share in its Commercial, Executive and Defense & Security divisions. In 2013, Embraer generated US$6.2 billion in revenues and currently has a market cap of US$7.5 billion.

Founded by the Brazilian Government in 1969, Embraer was privatized in December 1994 and subsequently listed on the Bovespa. Since its privatization, Embraer has become a global leader in the regional jet segment, figuring among the four dominant commercial aircraft manufacturers in the world. It has also been one of the few companies to prosperously (and disruptively) enter the business jet market, consistently increasing its market share over the years.

To give a perspective of the company's execution capacity, it is interesting to take a look at the market share evolution in the last 10 years. In 2003, Regional jets accounted for 78% of the company's sales, and Bombardier delivered 2.5 times more planes than Embraer. In 2013, this scenario changed significantly with Regional jets accounting for 53% of the company´s revenues, Executive aviation 26% and Defense & Security 20%. In this same year, Embraer delivered 3.5 times mores regional jets than Bombardier. What happened during this period?

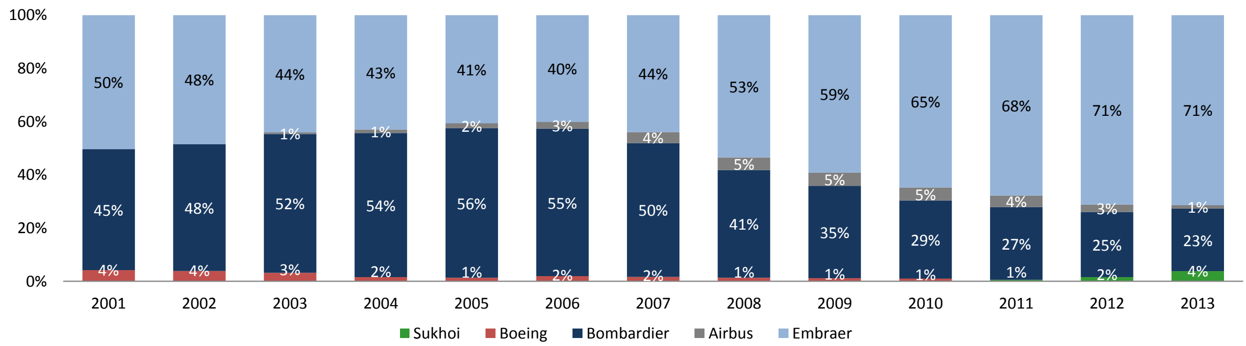
Commercial / Regional Jets Business

As mentioned above, the commercial aerospace market is dominated by four global players. To correctly analyze the market however, one has to separate it into two different segments. The first one is the large aircraft market (over 130 seats) dominated by Boeing and Airbus, which generates approximately U$80billion in revenues per year. The other is the regional jet market (up to 130 seats) which is dominated by Embraer and Bombardier and generates approximately US$8bi per year. As the first one is around ten times larger than the second and has a fierce competition between the two main players, none of them can afford to lose focus trying to capture a smaller market. This situation leaves Embraer and Bombardier battling for the regional jet market almost by themselves.

In the late 90s, after conducting an extensive survey, Embraer decided to launch a clean sheet family of planes in the 70-120 seat range, named the E-Jets, moving upmarket from the 30-50 seat jets (ERJ family). Bombardier, on the other hand, preferred to simply stretch its already existing family of 30-50 seat jets. Despite the higher development risk, a clean sheet project, tends to present better performance metrics that lead to reduced operating costs for the airlines. Once the major regional airlines started to migrate to this enlarged plane, Embraer quickly became the marker leader.

Evidence of barriers to entry is a relatively stable market share over time, with no new companies entering or exiting. As can be seen in the chart below, this can be considered the case for the regional jet market. Embraer, however, has increased its share throughout the years, without any relevant new entrants. This was mainly the result of an increased focus on this specific market, while Bombardier followed the path described above and also decided to enter the lower end of the narrow body market, challenging the incumbents which fiercely defended their market stakes.

Rolling 5-year Market Share (Regional Jet Delivery)



As mentioned in previous letters, competitive advantages are usually derived from four sources: supply, demand, economies of scale and, in certain industries, government. In this case, supply side advantage is practically inexistent as all the main players have access to the same global suppliers. From the demand side, Embraer enjoys a certain customer captivity which was constructed throughout the years. Once a customer decides to adopt a specific airplane model, there are significant switching costs for it to change to another model. Pilots have to undergo several hours of training and companies usually have to maintain large volumes of spare parts. That's why usually several airlines prefer to have only one family of jets.

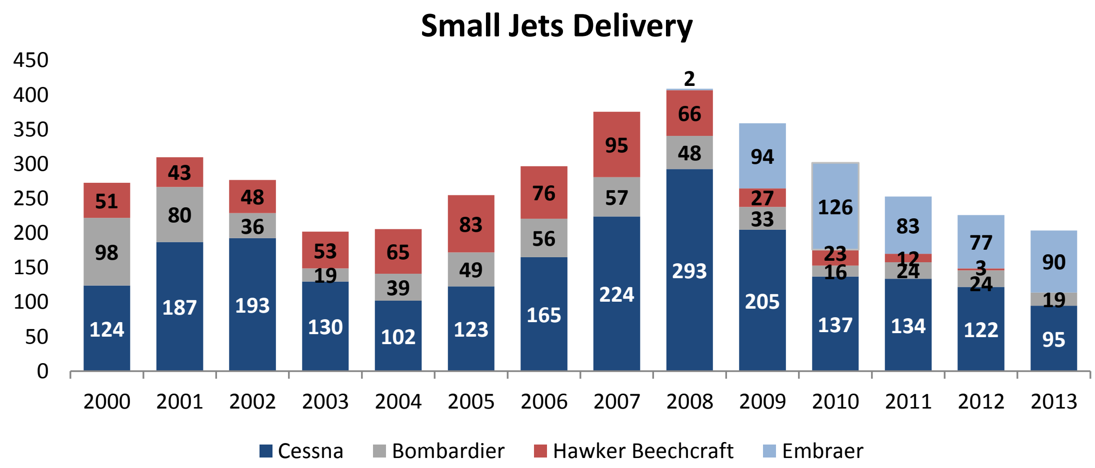
Over the years, Embraer has already delivered over eighteen hundred planes and built support centers with spare parts all over the world, increasing their customer captivity and creating economies of scale which are difficult to replicate. This increases the switching costs for current customers and helps to create entry barriers for new players.

Executive jets business

The executive jet market can be divided into three major segments: small, mid and large jets. It too has been dominated for more than a decade by only a handful of manufacturers. The main players in the large segment are Gulfstream, Dassault and Bombardier, while in the small and mid-segments the main players are Cessna, Bombardier, Embraer and until recently Hawker Beechcraft.

After having timidly entered the executive jet market in 2002 with the Legacy 600, a large business jet built on the ERJ commercial plane platform, Embraer carried out a detailed survey of the market and realized it would be very difficult to compete head to head in the large jet segment and that it had been quite a while since a new clean sheet plane was developed for the light jet segment. Again, their strategy proved to be extremely successful and since the introduction of the Phenom family of small jets in 2008, Embraer has consistently gained market share. In 2008, Cessna, the most relevant manufacturer of light jets, delivered 293 planes versus only 2 for Embraer. In 2013, as was the case in the commercial aviation segment, this scenario changed significantly, with Cessna delivering 95 planes, compared to 90 by Embraer. This success is explained by the higher quality of the company's planes, which introduced technology that was previously available only on larger jets, while also offering competitive pricing and operational cost propositions.

Embraer`s success in this industry is even more remarkable when the timing of its entrance is taken into consideration. In 2009, due to the global financial crises, the number of executive jets delivered fell to approximately 800, compared to more than 1,100 in the prior year. Despite this tough environment, Embraer delivered 94 jets in its first full year and was able to maintain this level of deliveries over the following years, being the only new manufacturer to successfully penetrate a highly competitive and concentrated market.



Defense business segment

Despite having initially been established to develop aircraft for the Brazilian Air Force, over the years the relevance of the Defense segment diminished significantly, representing only 7% of total revenues in 2007. Realizing that it could use the expertise it developed over the years in complex systems integration, Embraer broadened its scope and created a Defense and Security Unit, while also making small strategic acquisitions. Yet again, the company's decisive focus to provide new services and products led to strong results, with the company being chosen as the prime contractor for the development of the border control monitoring system (SISFRON), the development of a Brazilian satellite, among several other projects. Another strong indication of its superior quality products was the result of the United States Air Force bidding process for the trainer jets, where Embraer was chosen over an American company.

Investment perspective

Looking at the recent past of the company, it is truly impressive what they have built. If these successful entries had happened only once, one could have called them lucky. But if it starts to be recurrent, there has to be other reasons. Looking back, obviously it is not something that happened overnight. It's the result of several years of hard work, intense focus and careful allocation of capital. Borrowing a concept described by Jim Collins, Embraer has adopted a hedgehog principle, focusing on its core competencies and deploying them where they saw adequate returns, while being passionate about what they do. Pairing this with a strong culture of discipline, Embraer had the patience to keep on spinning the flywheel to arrive where it is today, being even more well positioned to achieve extraordinary results over the following years.

A problem that usually stops the flywheel is change of leadership, when new CEOs try to change the direction of the company. This is clearly not the case of Embraer, where Frederico Curado has been with the company since 1995 and as CEO since 2007. The company has several other distinguished executives, several of whom, like Frederico, graduated from ITA, one of the best aeronautical engineering universities in the world, and the birthplace of Embraer.

In the second semester Embraer will start delivering the new Legacy jets, entering the mid-size executive jet market for the first time. We expect these products to once again expand its market share, allowing Embraer to slowly move upmarket. Later from 2018 to 2020 Embraer will introduce their next generation E-jets. Coincidently, as we write this letter, the premier aerospace conference in the world is taking place in Farnborough, and Embraer is showing that yet again their strategy has paid off. While Embraer has captured 139 new firm orders, its main competitor has only captured 7. Adding the new orders to Embraer`s backlog, it stands at US$25 billion, the highest level since 2002 and with a richer mix, mainly the E190-195 family. In the defense front, we expect them to continue offering more defense-related solutions, not only aircrafts, while also increasing the KC-390 backlog.

In terms of valuation, in our base case scenario we currently see Embraer trading at a P/E multiple of 15x 2015 and expect an earnings CAGR of 13% (plus 2% dividend yield a year) over the next four years. What gives us confidence is that we are buying an excellent quality company at a moment of earnings growth, and therefore do not have to count on multiple expansion. It’s worth mentioning that we do not assume any additional devaluation of the Brazilian real in our model, which would positively impact operational margins.

Conclusion

We still expect 2014 to be a year of high volatility, mainly due to government issues and the elections. Even with the opposition gaining ground in the election’s polls recently we still count on turbulence throughout this year.

On the company side, we are sad to share that after 5 years, Camila Fairbanks decided to leave us to dedicate more time to her children and family for some time. She is proud of what she was able to achieve at Constellation, helping to establish the firm's international client platform and admirable reputation. Above all, she is deeply grateful for the friendship and ongoing support from everyone throughout these years and is sure that her departure from Constellation does not in any way mark the end of our relationship. We wish her all the best.

We value your relationship and the trust you have placed in us by investing in Constellation. Our investor relations team will be glad to answer any further questions.

Sincerely,

Constellation Team

Constellation
ASSET MANAGEMENT

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Constellation Fund SPC Equities Class – Long Only

Fund Objective

The fund's objective is to provide sophisticated investors with superior risk-adjusted returns by investing in stocks at the Brazilian Stock market through a rigorous research driven "bottom-up" fundamental approach, while carefully attempting to control portfolio risk and transaction costs. The fund does not intend to track market indices and is generally invested 80% to 105% of the NAV. Leverage is rarely used and we attempt to avoid excessive concentration.

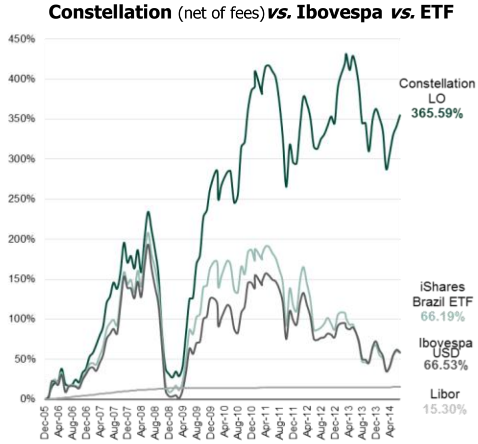
Share Appreciation (Net of all fees and audited by KPMG)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	Since Incep.
2005												2.45%	2.45%	2.45%
2006	12.28%	4.59%	1.81%	12.98%	-13.71%	-1.74%	0.87%	5.37%	-2.81%	9.94%	3.77%	10.64%	49.33%	52.99%
2007	3.43%	6.07%	7.08%	6.20%	15.43%	3.71%	7.66%	-3.21%	8.31%	14.71%	-8.38%	3.03%	82.52%	179.22%
2008	-5.66%	8.81%	-9.70%	16.76%	10.62%	-6.76%	-8.13%	-13.70%	-27.40%	-24.95%	-5.06%	-3.36%	-55.75%	23.55%
2009	5.88%	-4.40%	9.14%	29.69%	23.55%	0.65%	18.58%	4.21%	16.85%	2.64%	8.23%	6.14%	203.31%	274.75%
2010	-9.52%	5.32%	4.32%	0.30%	-10.20%	2.60%	16.98%	1.52%	9.54%	5.25%	1.07%	3.91%	32.09%	395.01%
2011	-5.48%	1.73%	5.06%	0.36%	-1.39%	-1.62%	-5.92%	-9.51%	-14.43%	14.36%	-5.27%	-0.24%	-22.57%	283.28%
2012	11.85%	8.14%	-1.81%	-3.72%	-7.99%	-0.62%	2.85%	1.50%	2.50%	2.61%	-1.82%	10.47%	24.53%	377.23%
2013	5.52%	2.44%	-3.79%	3.44%	-6.10%	-10.33%	-0.05%	-7.95%	9.47%	3.18%	-2.41%	-3.89%	-11.71%	321.35%
2014	-10.66%	4.85%	5.67%	2.69%	3.07%	5.48%							10.50%	365.59%

Exposure (Delta Adjusted)

Sector	% Long NAV
Education	21.39%
Financials	17.19%
Consumer Staples	14.12%
Services	13.81%
Fuel distribution	8.22%
Utilities	6.03%
Industrials	4.18%
Consumer Discretionary	3.82%
Metals & Mining	3.39%
Homebuilders	2.04%
Index Hedges	-1.73%
Total	**92.46%**
Exposure to the BRL	80.08%

Constellation (net of fees) *vs.* Ibovespa *vs.* ETF



Number of Positions

Stocks	23

Value per Share (net of all fees)

As of June 30th, 2014	531.4310

Sector Attribution

Outperformers	**% NAV**
Education	1.60%
Financials	0.59%
Utilities	0.59%
Underperformers	**% NAV**
Metals & Mining	-0.12%
Industrials	-0.04%

Overall Strategy Liquidity (1/3 of Average Daily Traded Volume)

Tenor	
1 Day	27.7%
1 Week	64.0%
1 Month	86.7%

Market Capitalization

>US$10 bn	26.5%
>US$ 1 bn and <US$10 bn	61.6%
<US$1 bn	4.3%
Total Equity Exposure	**92.4%**

Main Characteristics

Inception Date:	November 30, 2005.
Initial Investment:	US$ 100,000
Subsequent Investment:	US$ 50,000
Subscriptions:	Last Business Day of the month.
Redemptions:	Available series: monthly with 3 months prior notice.
Payments:	Three business days after the redemption day.
Advisory Fee:	1.0% per annum.
Incentive Allocation:	10% of the profit paid annually or upon redemption.
Net Asset Value:	Daily net of advisory fee.
AUM of the Strategy:	US$ 1,167,291,749

Risk x Return Profile (Since Inception – Net of all Fees)

Annualized Return	19.66%
Annualized Ibovespa USD Return	5.90%
Annualized Standard Deviation	32.10%
Ibovespa USD Annualized Standard Deviation	47.90%
# of Positive Months	65
# of Negative Months	38
Best Monthly Return	29.69%
Worst Monthly Return	-27.40%
ISIN:	KYG238261112

Constellation
ASSET MANAGEMENT

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Constellation Fund SPC Class B - Long Short

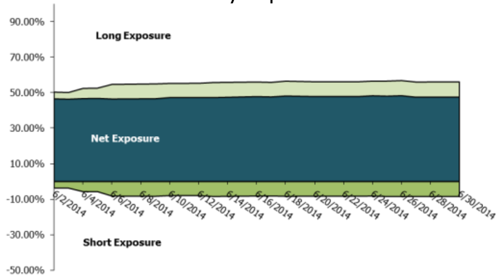
Fund Objective

The fund's objective is to provide sophisticated investors with superior risk-adjusted returns in any market environment. To achieve the objective, the fund employs a classic long/short equity strategy by investing in stocks at the Brazilian Stock Exchange, while carefully attempting to control portfolio risk and transaction costs. Our stock selection is based on rigorous research driven "bottom-up" fundamental analysis.

Share Appreciation net of all fees (* Performance of Long Short Class A until Nov 04, Class B onwards.)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	Since Incep.
2002 *												2.27%	2.27%	2.3%
2003 *	0.97%	1.00%	1.11%	1.65%	-0.29%	0.68%	0.25%	3.10%	2.92%	1.45%	4.71%	1.60%	20.81%	23.6%
2004 *	3.52%	0.22%	0.26%	-1.99%	-0.79%	0.58%	0.68%	3.38%	2.70%	0.67%	-0.09%	8.37%	18.52%	46.4%
2005	6.13%	4.90%	-3.81%	-2.86%	0.50%	1.15%	-1.49%	1.26%	9.20%	-2.11%	4.48%	2.51%	20.76%	76.8%
2006	6.61%	1.20%	-0.38%	8.68%	-3.72%	-1.03%	0.57%	3.67%	-1.85%	0.89%	0.53%	3.42%	19.46%	111.2%
2007	0.85%	3.13%	2.76%	0.87%	5.00%	-0.28%	2.90%	-2.10%	2.54%	3.43%	-4.58%	2.70%	18.18%	149.6%
2008	-1.77%	-0.57%	-3.92%	1.47%	2.45%	-2.11%	-2.67%	-4.32%	-5.36%	-7.55%	-1.10%	-2.39%	-24.88%	87.5%
2009	-0.15%	-1.01%	2.03%	3.69%	4.19%	0.32%	6.20%	1.11%	7.73%	2.45%	2.34%	2.40%	35.75%	154.5%
2010	-2.83%	1.74%	0.93%	-0.04%	-3.60%	0.75%	6.23%	0.95%	3.23%	1.35%	0.75%	1.12%	10.74%	181.9%
2011	-1.56%	0.03%	1.78%	-0.19%	-0.94%	-2.22%	-2.08%	-3.28%	-3.82%	1.66%	-1.61%	-0.54%	-12.19%	147.52%
2012	3.12%	2.66%	-0.62%	-2.03%	-2.57%	-0.59%	2.33%	0.01%	0.58%	0.86%	-2.46%	5.80%	6.96%	164.75%
2013	3.04%	1.87%	-2.26%	2.13%	-3.98%	-5.91%	-0.13%	-6.29%	5.55%	3.29%	-1.31%	-3.08%	-7.60%	144.63%
2014	-7.01%	3.31%	4.05%	1.94%	1.90%	2.73%							6.68%	160.97%

Daily Exposure



Total Portfolio P/L (Gross of Performance Fee)

	Apr14	May14	Jun14	2014
Longs	1.23%	2.25%	2.25%	2.30%
Shorts	(0.29)%	0.02%	0.02%	0.01%
FX/FX Options/Fixed Income	1.08%	(0.11)%	0.69%	5.56%
Equity /Index Options	0.10%	(0.06)%	(0.03)%	(0.02)%
Others Expenses	(0.18)%	(0.20)%	(0.20)%	(1.09)%
Total	**1.94%**	**1.90%**	**2.73%**	**6.68%**

Sector Exposure (Delta Adjusted)

Sector	Long	Short	Gross	Net
Education	11.9%	0.0%	11.9%	11.9%
Consumer Staples	7.5%	0.0%	7.5%	7.5%
Services	7.3%	-0.4%	7.7%	7.0%
Financials	8.9%	-2.2%	11.1%	6.7%
Fuel Distribution	6.5%	0.0%	6.5%	6.5%
Utilities	3.9%	0.0%	3.9%	3.9%
Metals & Mining	2.7%	0.0%	2.7%	2.7%
Consumer Discretionary	2.0%	0.0%	2.0%	2.0%
Industrials	1.6%	0.0%	1.6%	1.6%
Homebuilders	3.7%	-2.3%	6.0%	1.4%
ETFs/IBOV/Options	0.0%	-3.1%	3.1%	-3.1%
Total	**56.0%**	**-8.0%**	**63.9%**	**48.0%**
Exposure to the BRL				43.4%

Number of Equity Positions

Long	22
Short	4

Value per Share (Net of all Fees)

As of June 30th, 2014	**218.4799**

Overall Strategy liquidity (1/3 of Daily Average Traded Volume)

Tenor	Long	Short
1 Day	75.2%	90.0%
1 Week	92.4%	100.0%
1 Month	100.0%	100.0%

Market Capitalization

	Long	Short
>US$10 bn	14.7%	3.2%
>US$ 1 bn and <US$10 bn	38.4%	2.6%
<US$1 bn	3.0%	2.2%
Total Equity Exposure	**56.0%**	**8.0%**

Main Characteristics

Inception Date*:	November 30, 2004.
Initial Investment:	US$100,000
Subsequent Investment:	US$50,000
Subscriptions:	Last Business Day of the month.
Redemptions:	Available series: monthly with 3 months prior notice.
Payments:	3 business days after the redemption day.
Advisory Fee:	2.0% per annum.
Performance Fee:	20% of the profit paid annually or upon redemption.
Net Asset Value:	Daily net of advisory fee.
AUM of the Strategy:	US$ 124,611,968

Risk x Return Profile** (Since Inception – Net of all Fees)

Annualized Return	8.66%
Annualized Standard Deviation	10.60%
Sharpe Ratio*	0.67%
# of Positive Months	69
# of Negative Months	46
Best Monthly Return	11.14%
Worst Monthly Return	-7.55%
ISIN:	KYG238261039

* Annualized T-Bill 90 daily return.