

# The growth story

Latam hedge funds have seen huge growth this decade, predominantly from local investors, but with diversity and potential returns luring offshore investors, what do hedge fund managers need to do to prosper in tomorrow's market?

**By Annie Roberts**

The growth of the Latin American hedge fund space has exploded over the past decade. As of July 2011, the number of funds was nearly four times that at the end of 2000, while assets over the same period recorded an increase over 23-fold. Hedge funds now count for around 20% of the fund industry in Latam, and there are currently approximately 442 operational hedge funds managing over \$64bn in assets, according to a July report from Eurekahedge.

According to Kenneth Heinz, president of Hedge Fund Research (HFR), international investors are looking for emerging market hedge funds as a way to access the secular growth of those regions. "Up until August of this year, Latam's hedge funds were more favourable and stable, with the region's secular economic situation of higher growth than the developed world. As a result, investors are looking at specialist managers to help them access the benefits of this growth."

Andrew Weir, portfolio manager at Stenham Advisors explains that in the last four years, the Brazilian hedge fund industry has moved from a focus on domestic investors to opening up to external flows.

"The main thing that attracts us is the growth story and diversity of the industry. The hedge funds are focused on the local market which we can use to diversify our global portfolio. You won't see the same assets in a Brazilian long/short portfolio as you would in a US long/short portfolio and a European long/short portfolio, which really does add diversification and value."

Domestically, the pension fund system and the banking system are growing at a fascinating rate in Latam and they're starting to invest in the hedge fund industry. According to Daniel Osorio, CEO of Andean Capital Management, this trend is likely to follow internationally. "There will be growth in the Andean region per annum of approximately 6-8% depending on the country, which won't be the case in Europe or in the US. Quite naturally investment capital will flock to the countries that are experiencing growth."

"The boom in commodity prices for metals, agricultural products, and oil combined with political stability in the majority of the countries in the region are the most significant factors that make the Andean region's markets attractive for investing," says Osorio.

However, right now the hedge fund industry in Latam is predominately receiving inflows from local investors. According to Patric de Gentile-Williams, COO of FRM Capital Advisors (FCA), the hedge fund seeding division of fund of hedge funds group Financial Risk Management (FRM), taxes make it expensive for global investors to invest in onshore funds and the high local interest rates mean that a



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**"If you want to set up a hedge fund with institutional inflows and with leverage you need to set up the fund offshore"**

- **Martin Litwak**

## AIMA: Building bridges with Brazil

Earlier this year, the Alternative Investment Management Association (AIMA) launched a new initiative to engage with the Brazilian hedge fund industry. Michelle Noyes, head of international sales and investor relations at BRZ Investimentos, was appointed as the local representative of the market.

ANBIMA, the Brazilian industry regulator works closely with AIMA to improve dialogue between Brazilian managers and the wider hedge fund industry, the global hedge fund association said.

"It is great to have an opportunity to help the industry," Noyes told LatAm FM earlier this year. "AIMA is looking to work with ANBIMA, which is already very strong in Brazil, as more and more fund managers are looking to work abroad and are showing an interest in countries such as

Brazil," she added. "It is very exciting to improve the dialogue between the Brazilian and global industries."

Andrew Baker, AIMA's CEO, is keen for AIMA to play its part in the maturation of Brazil as part of the global hedge fund industry. "The maturity and sophistication of the Brazilian hedge fund industry has been noted internationally, and what is clear is that there is not only an interest in Brazil from the global industry - whether from managers, investors or service providers, but there is also an increasing desire from the Brazilian industry to engage and to think globally," said Baker.

"We see our role as opening up an international channel of communication so that the Brazilian industry can engage in dialogue on key industry issues with its colleagues internationally," he added.



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COO, FRM Capital  
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currency hedge will subtract substantially from returns. "Together these depress the returns available to a global investor versus returns they can receive from hedge funds in other regions," he says.

Though global investors are increasingly looking to Latam funds in line with increased flows to emerging markets globally, a number of obstacles discourage investors. The recent policies by the Brazilian central bank to deter speculation in the real have made it more expensive to invest in onshore Brazilian funds.

"The mismatch in liquidity between onshore and offshore funds is also a deterrent to international investors. Onshore liquidity is usually daily or weekly, while offshore funds are often structured to be monthly or quarterly in line with hedge funds globally, leaving offshore investors at a liquidity disadvantage," says Gentile-Williams.

"Global hedge fund investors are willing to pay hedge fund fees for alpha, but they want to pay lower fees for beta. When it comes to

investing in Brazilian hedge funds, this is a factor. If a hedge fund is generating equity beta, for example, it may be attractive to a local investor as it represents a good alternative to interest rates, but to a global investor once the taxes, hedging costs and fees are subtracted, it is a very expensive form of beta," he adds.

While there are a few Latam managers looking to attract foreign investors through offshore funds, and likewise a few international players looking to gain a local edge, for the most part the industry is still a local one. "A few Brazilian hedge funds have created offshore products, and so global investors will typically invest through these vehicles, but they represent a small portion of the local industry," says Gentile-Williams.

"However, the size and growth of the Brazilian savings base means that the hedge fund industry is able to experience healthy growth without international investment," he adds.

### The managers

A theme tracked by HFR among emerging market hedge funds that is also evident among Latam hedge funds is that the managers offering these funds believe there is a distinct and tangible benefit to operating them on the ground in their local markets rather than operating them from global locations.

"Although we see some Western managers setting up footholds, for example in the private equity and fixed income space, the industry is still predominately domestic. However, as Brazil continues to grow we would expect more managers to establish a presence," says Gentile-Williams.

"Several years ago, the relative youth of Brazilian hedge fund managers compared to managers globally was notable. The long period of stability and bull markets leading up to 2008 meant that few managers had experienced periods of heightened volatility. However, the difficulties experienced by many managers during the crisis has only served to improve the industry and help it to mature," he adds.

### Regional variances

The majority of hedge funds in Latam (80%) are domiciled in Brazil due to the scale and depth of Brazilian markets compared to its neighbours; Brazil is where most of the liquidity and market capitalisation is, as well as the ability to short.

According to Martin Litwak, partner at Lit-

## The HFA comes to Latam

The non-profit Hedge Fund Association (HFA) expanded into Latam in March this year. Victor Hugo Rodriguez, CEO of LatAm Alternatives (pictured), was appointed by the HFA's board to serve as the director of the Latin American Regional Chapter. Marcia Rothschild, Citibank, and Otavio Vieira, Fides Asset Management, serve as co-directors of the Brazilian Chapter. Additionally, Juan Luis Rivera, Moneda Asset Management is director of the Chilean Chapter, Daniel Osorio, Andean Capital Management takes the reins as director of the Colombian Chapter, Martin Litwak, Litwak and Partners and Michelle Furnari, LatAm Alternatives are co-directors of the Argentinean and Uruguay Chapter, and Les Baquiran of Park Hill Group (a division of the Blackstone Group) is director the New York-Latam Chapter. Carlos Rojas, Andino Capital Management is director of the Peruvian Chapter and Panama Chapter director is Jose Abbo, SFC Investments.

"The Latin American Chapter is

already one of the fastest growing chapters of the HFA and we think this is reflective of the fact that alternatives in Latin America are coming of age and are ready for prime time," says David Friedland, president of the HFA and president of Magnum US Investments.

Rodriguez explains that the HFA's main focus is to educate the public, the media and the government, creating a good understanding and dispelling common misperceptions about the hedge fund industry in Latam. The HFA recently held an event in New York for investors and hedge fund managers to increase their understanding of the Latam hedge fund community and effectively engage in the region.

"The objective of the event was to create awareness of the well-developed hedge fund industry in Latam, which is taking the necessary steps to compete with other regions and emerging markets," he says.



wak and Partners, although Brazil has a clear advantage over the rest of Latam, other countries such as Chile and Argentina also have an active industry and more funds are being created in Peru, Columbia, Venezuela and Mexico.

Andean Capital Management's Osorio is focused on opportunities in the Andean region. "It is an attractive region for investing as there are many exciting opportunities and very few funds looking for those opportunities. The opportunities may be smaller than that of Brazil but the we think the risk/reward is bigger as there are less people looking for opportunities in the Andean region than there are in Brazil."

Marcia Rothschild, Citibank's Latin America client and sales management head, explains that due to the high number of Brazilian managers (450 as of September according to Anbima), "It becomes difficult to make a splash in Brazil, so fund managers need to be thinking outside the box and doing things that will make them stand out from the crowd. They are also reaching out to other countries in Latam," she says.

"With the current financial crisis in Europe and the US, we are seeing increasing intra-regional flows, not only in terms of fund launches, but also M&A activity, such as firms like BTG Pactual and Chile based Celfin for example," she adds.

The CVM requires a higher level of regulation of hedge funds when compared to the US or Europe although the countries in Latam are at very different stages of development in terms of regulation. In Brazil, where hedge funds are highly regulated and a daily NAV is required, there is a lot of transparency.

"Countries such as Columbia, Peru and Chile are really in their infancy in terms of hedge fund regulation, so a lot of ground-work has to be done. Mexico's legislation for example, creates a very difficult environment to work with, but that is gradually changing," says Rothschild.

Although there is a lot of potential in the region, especially in Brazil, and while the high levels of regulation are good for the investors in those funds, it makes the development slow. According to Litwak, not every country in Latam has regulation for hedge funds but he predicts that more countries will follow in Brazil's footsteps and have flexible legislation to allow for these products to be created.

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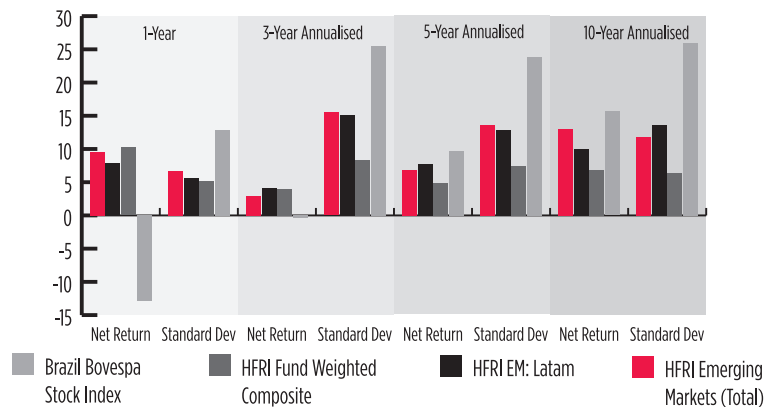
- **Marcia Rothschild**

set up a hedge fund with institutional inflows and with leverage you need to set up the fund offshore," he says.

"We are creating funds all the time - this month we put together three new funds, one for a Peruvian manager and two for a Brazilian manager that are based in Miami, that will be launching soon, all setting up offshore," he adds.

HFR LATAM AND EM HEDGE FUND INDEX PERFORMANCE PERIODS ENDING JULY 2011

Source: Hedge Fund Research



ESTIMATED SUB-REGIONAL COMPOSITION OF EM HEDGE FUNDS 2002 - Q2 2011

Source: Hedge Fund Research

