Institutional Investor

Brazil 20: BB Gestão de Recursos Still Hot Despite Cool-Down

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Few things have been hotter in the world of finance lately than Brazil and hedge funds. That country's robust economy, high interest rates and strong currency have attracted huge inflows of capital, while the hedge fund industry has recovered from its losses during the financial crisis to set all-time highs for assets under management.

It's no small irony, then, that hedge funds in Brazil are having a hard time.

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Multimercados, as hedge funds are called in Brazil, have slumped this year after a decade of phenomenal growth. Assets under management of multimercados were up just 2 percent on June 3 from the end of 2010, at $248 billion, compared with growth of 12 percent in the same period for the country's entire fund management industry, to $1.13 trillion, according to the Brazilian Financial and Capital Markets Association, known by its Brazilian acronym Anbima.

A decline in Brazilian equities and rising interest rates have hurt the performance of most multimercados. With Brazil's central bank maintaining the highest interest rates of any Group of 20 country, in a bid to contain inflation, many investors are shunning risk and putting money into short-term fixed-income products. As assets shift away from multimercados, many bankers see pressure growing for consolidation that will favor larger firms.

"I cannot see multimercados recovering in terms of their market share. Fixed income is the flavor of the day," says Marcelo Mello, vice president of investments at SulAmérica Investimentos, the money management arm of insurer SulAmérica. "I think Brazilian investors who want to take risk will turn directly to equities. Multimercados are an outdated product. They were designed for a time of easy alpha. Nowadays, Brazilian investors seek beta. Why have all the risk of alpha when investors can have such good returns without taking any risk?"

The recent volatility in equity markets stemming from concerns about Greece's debt situation has spurred a shift in investor preferences, says Allan Hadid, chief executive officer at BRZ - Investimentos, a Brazilian hedge fund manager in São Paulo. "Investors are moving away from macro hedge funds to low-volatility, guaranteed-returns investments, including fixed-income time deposits, fixed-income real estate funds, corporate bonds and credit-linked products," he says. As a result, he adds, "a lot of smaller managers are really suffering."

This being Brazil, of course, the suffering is relative. The hedge fund industry has continued to grow this year, but the pace pales in comparison with the dramatic expansion of recent years. Multimercado assets grew by 26 percent in 2010 and by 70 percent in 2009, according to Anbima. The recent sluggishness also stands in contrast to the vibrancy of the overall money management industry, whose assets are increasing at a healthy double-digit pace this year.

The industry's dynamism is evident in the Brazil 20, Institutional Investor's exclusive annual survey of the country's 20 largest money managers. These firms saw their collective assets increase to $910 billion as of March 31, up 29.3 percent from $704 billion at the end of 2009.

BB Gestão de Recursos, the fund management arm of state-owned Banco do Brasil, continues to extend its lead at the top of the ranking. The firm's assets grew by 36.5 percent during the period, to $239.3 billion at the end of March. There is little change in the overall order, although Credit Suisse, whose Credit Suisse Hedging–Griffo Asset Management unit is a leading hedge fund manager in Brazil, rises one place to tenth on the list, thanks to a 39.4 percent rise in assets, to $19.3 billion.

Brazil is home to some 400 asset managers that offer a wide range of multimercados, including 3,285 multistrategy funds, 1,922 funds of funds, 417 macro funds, 333 fixed-income/currency funds and 211 sector-specific funds, according to Economatica, a data provider with offices in São Paulo and New York.

Multistrategy funds increased their average net asset value by 6.4 percent this year as of June 10, compared with a rise of 18.8 percent for all of 2010 and 18.2 percent in 2009, Economatica data show. Funds of funds posted average gains of 3.9 percent as of June 10, compared with 9.7 percent in 2010 and 14.6 percent in 2009. Macro funds were up 2.9 percent this year, compared with increases of 8.9 percent last year and 21.9 percent in 2009.

The big universe of funds creates pressures for managers. "The multifunds industry is now incredibly competitive," says Ennio Moraes, superintendent of Citi Wealth Management in São Paulo. "There are a lot of managers with very low volumes, and this is stretching profitability."

Most multimercados pursue a basic investment approach, known locally as the "Brazilian kit." They invest about two thirds of their portfolios in local bonds and place most of the remainder in Brazilian equities. Most funds hedge their currency and interest rate risks only to a limited extent. Just 20 percent of multimercados engage in short-selling of securities, a basic staple of hedge funds in the U.S. and Europe, according to Safdié Asset Management, a Brazilian wealth manager. Funds can leverage up to 250 percent of their assets by using futures and options.

"Multimercados perform well in a bull market," says Rodrigo Campos, macro strategist and partner at

Constellation Asset Management, a São Paulo–based hedge fund manager. “The equity portion of their portfolios is normally long only. Most do not stock pick on the short side. If they want to hedge, they will do so mainly with the Bovespa index futures.”

Brazil is far from bull market territory, though. The stock market was down by 11.32 percent in reais, and by 7.25 percent in dollar terms, for the year as of June 23, according to LatAm Alternatives, a Weston, Florida–based hedge fund consulting firm. The Bovespa has seen the second-biggest drop, in dollar terms, among the BRIC countries. The Bombay Stock Exchange’s Sensex was down 14.79 percent in that period, the Shanghai market was off 3.81 percent, and Russia’s Micex index was up 6 percent.

Meanwhile, Banco Central do Brasil has increased its key short-term interest rate, the Selic, from a low of 8.75 percent in March 2010 to 12.25 percent today, after a 25 basis point hike in June. Most analysts expect interest rates to remain elevated through 2012. For Brazilian investors such high rates change the game significantly, industry executives say. They know they can make good returns just by investing in fixed income and certificates of deposit with no need to pay multimercado managers’ typical 2 percent management fee and 20 percent performance fee.

Lately, investors have poured money into short-term deposits, which have increased by 15.4 billion reais ($9.8 billion) as of June 10 since the start of the year, according to Anbima. Other popular sectors include inflation-linked bonds, which were up by 8.9 billion reais, and equity sector funds, which were up by 13.34 billion reais, fueled in large part by the growth of telecommunications and oil and gas funds.

Inflation-linked bonds have also been a big winner. They saw an inflow of 4.74 billion reais between the start of the year and May and of 62.9 billion reais for the 12 months to May. By contrast the only multimercado sector to enjoy any notable inflows this year is multistrategy, which was up 2.46 billion reais from the start of the year.

“Multimercados fund managers have been very successful in the past,” says Otavio Vieira, chief investment officer at São Paulo–based Safdié, which manages 1.3 billion reais in assets. “Today their returns are very dispersed, but many just cannot generate alpha, they cannot beat the risk-free rate. It is becoming very hard for them to justify their fees.”

Some managers are responding to the pressure by lowering management fees or trying to diversify their client bases by attracting long-term investors such as endowments, pension funds and sovereign funds. “Some houses will be forced to consolidate,” he adds. “Others will start to focus on consulting to asset and wealth management industries.”

The recent sluggishness is a dramatic change from the rapid growth of multimercados over the past decade. The sector started to take off in 2003 after the Comissão de Valores Mobiliários, Brazil’s securities regulator, introduced rules targeted at the industry. Credit Suisse Hedging–Griffo was one of the first managers to introduce funds with a 14-day redemption period and followed that with funds with 30 days' redemption in 2005. Hedge funds performed very well in the country during the 2006 and 2007 period, when asset valuations surged in the country and Brazil experienced a record number of IPOs. A series of reductions in interest rates from the historical levels of about 20 percent to 12 percent also encouraged investors to consider alternatives to fixed-income products.

Multimercados face among the toughest regulation of any hedge fund industry worldwide and differ from hedge funds in the U.S. in a number of ways. They must disclose their holdings to regulators on a monthly basis; they are audited and publish their NAVs every day; and they must maintain segregation of functions between management, administration and custodial. Mutual funds and multimercados are covered by the same regulations in Brazil.

"Brazilian multimercados are not the 'black box' hedge funds that you see in some funds," says Ibrahim Hajjar, a partner at Credit Suisse Hedging–Griffo. "They have no side pockets. They cannot take on leverage like U.S. hedge funds. The strong legislation means that multimercados did not suffer any blowup during the international financial crisis. This made Brazilians very comfortable about the regulatory environment in Brazil and more confident about investing in multimercados."

In 2009 the CVM put in place new regulations that stopped proprietary traders from taking leverage on to their balance sheets. A lot of top traders saw this as the right moment to set up their own hedge funds. Managers also started to offer better remuneration packages, and many Brazilians in New York or London decided to return home.

Traditionally, Brazil's investment funds industry has been dominated by banks, mainly the big retail banks with large distribution channels, such as Banco Bradesco, Banco do Brasil and Itaú Unibanco - Holding. In recent years, however, the banks have gone through a process of consolidation, and a number of senior executives in asset management decided to leave and to set up independent firms specializing in hedge funds.

"Three factors led to a burgeoning industry during the past few years: the solid legislation underpinning the industry, CDI rates getting lower and an influx of high-quality managers," says Hajjar.

Although growth has stalled this year overall, one multimercado sector — those specializing in overseas markets — remains hot.

In February 2008 the Brazilian regulator began allowing onshore funds with qualified clients to invest up to 100 percent in overseas assets. A qualified investor must have a minimum of 300,000 reais in liquid assets and the fund must have a minimum size of 1 million reais to be eligible. These vehicles have much more flexibility and can also invest up to 100 percent in asset-backed securities, other funds and a limited number of stocks.

Various managers — including Rio de Janeiro–based Gávea Investimentos, London-based Gems Advisors and São Paulo–based BTG Pactual — were quick to offer funds that invest offshore. Today there are 95 offshore funds managing a combined total of 51.4 billion reais in assets, according to Anbima.

“The chance to invest in overseas markets has been one of the biggest changes to the multimercado industry during the past few years,” says Rodrigo Borges, head of multiassets at HSBC Gestão de Recursos in São Paulo, which ranks sixth on the Brazil 20, with $45.4 billion in assets, of which 10 percent is invested in multimercados. “The average Brazilian investor is beginning to understand foreign markets better. More and more of them are seeking to diversify through foreign assets.” HSBC estimates that 10 to 15 percent of assets in its multiasset funds are invested offshore today, up from 5 to 10 percent a year ago.

“The rule change has expanded the horizons of Brazilian managers,” says Hajjar of Credit Suisse - Hedging–Griffo. “Brazil is well and truly part of the global economy, and the change means that managers can now trade the whole world.”

More and more Brazilian managers are expanding their research teams to cover other key markets in the world and are opening offices in New York and London.

Some managers believe opportunities exist to set up offshore funds catering to international players that invest in Brazilian assets. Park Hill Group, a global alternative-asset placement agent that’s part of the Blackstone Group, is raising assets for Brazilian managers from endowments, foundations, funds of funds and family offices around the world. Currently, it is working to raise assets for Leblon Equities, a Rio de Janeiro–based asset manager, for its long-only, hedge fund and hybrid funds.

“We are in contact with many foreign LPs about investing in Brazil,” says Les Baquiran, a partner at Park Hill. “We have seen interest from investors in North America, Europe, the Middle East and Asia.

“Most local funds in Brazil have daily liquidity with short notice periods and only on occasion have monthly and longer lockups,” he says. “However, the majority of offshore funds have monthly, quarterly or even lockups of up to three years. This is a good fit for institutional investors who may have longer-term investment horizons.” The high volume of IPOs and follow-ons in the country during the past few years has created a much broader universe of stocks for traders to play long or short, Baquiran adds.

However, some managers believe that Brazilians are not yet prepared to invest in overseas assets. They stood on the sidelines as advanced economies suffered during the international financial crisis but saw that Brazil was the last major economy to enter a recession and the first one to come out of it. They are also discouraged by current events in Greece and in the euro zone more widely.

“In my view, Brazilian investors have no real appetite yet to invest in offshore assets,” says Constellation’s Campos. “They don’t understand how the Japanese yen works, and their perception is that local managers are not capable of trading in it either. They expect managers to trade only in local markets. This perception could well be wrong, as Brazil has a lot of talented managers — but the truth is managers cannot ignore their mandates or investors' wishes."