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Keeping Cool

Latin America is fertile ground for hedge funds due to macroeconomic policies that withstood the brunt of the financial crisis, says Victor Hugo Rodriguez, managing director of the Hedge Fund Association and director of its Latin American chapter, but efforts to support investment must be tempered by an awareness of the risks of overheating.

“Following the crisis, the Latin American region picked up again in 2009 and stabilised in 2010,” says Rodriguez. “It now has a great outlook for the coming years, and we believe capital will flow into the region at a faster rate than before.”

The HFA was founded in 1995 with the aim of uniting the hedge fund industry and providing it with a voice to influence public policy. Rodriguez’s appointment in March is part of an ongoing global expansion programme.

The Latin American hedge fund community may be smaller than in other markets, but it has exhibited strong growth over the past 10-15 years. Hedge funds in the region currently hold a total of US$60 billion assets under management (AUM), compared to US$360 billion in Europe and US$113 billion in Asia, according to Eurekahedge, an independent research provider. However, over the last decade, the number of hedge funds in the region has increased fourfold and AUM has grown by nearly 25 times.

“Now is the time for the HFA to take a role among mid-to-large-sized hedge funds and show that region is mature enough to compete with others in terms of transparency and returns,” says Rodriguez.

Much of the growth in the region has been driven by Brazil, says Rodriguez, which is now reaping the benefits of macroeconomic policies initiated in 2002/2003.

“Brazil put in place a deficit reduction programme and implemented fiscal disciplines that encouraged investor confidence,” he says. Fiscal reform was accompanied by an overhaul of regulatory oversight. “The regulator has insisted that hedge funds in Brazil report all of their positions, which has encouraged transparency and made firms feel safe when investing in the country.”

Despite suffering substantial redemptions during the financial crisis, which saw the AUM of hedge funds in Latin America decline 37.2% from US$54.8 billion in June 2008 to US$39.3 billion in March 2009, Rodriguez believes that economic growth and stability across the region have changed investor perceptions.

“Latin America is no longer the little child on the back of the US and the whole region is a lot more stable compared to 15 years ago,” he observes. “Economists are now viewing Latin America as a region you have to be in to diversify exposures. Geographically, the region is safer than others such as the Middle East and Europe, which both continue to face challenges.”

During a meeting of the Inter-American Development Bank in Calgary at the end of March, Dominique Strauss-Kahn, managing director of the International Monetary Fund, said, “Growth in most Latin American economies is now back at potential, or above – and in many of them there are worrisome signs of overheating. Clearly, the earlier economic stimulus needs to be reversed.”

Rodriguez acknowledges that there is a balance to be struck between facilitating inward investment and fuelling asset bubbles.

To control foreign investment, Brazil has levied a tax on overseas investment, which covers equity, fixed income and derivative purchases, since October 2009. The tax is currently set at 2% for equity and derivatives transactions, and was raised from 2% to 6% for fixed income transactions in October 2010.

One example of a structural shift in the financial infrastructure of Latin America designed to reduce investment barriers is Mercado Integrado Latino Americano (MILA), the project to integrate the stock exchanges of Chile, Colombia and Peru.

The MILA project will enable investors in Chile, Colombia and Peru to send orders to each other’s markets using the DMA capabilities of local brokers. This will give foreign investors the ability to trade across the three markets – which have a joint market capitalisation of US$557 billion – seamlessly, without having to establish local broker links. The integration process has already started and the link is expected to be fully operational by May.

Brazil is also looking to establish ties with the MILA exchanges, with domestic exchange BM&F Bovespa having signed its own linkage agreement with Chile at the end of 2010, and stating that it will look to forge similar partnerships with Colombia and Peru during this year. Reports have also suggested that BM&F Bovespa and the Mexican stock exchange will also enter into an order routing agreement by the end of 2011.

“By opening up their frontiers to entice greater foreign investment and continuing to develop macroeconomic policies, smaller Latin America countries like Chile, Colombia and Peru will help to maintain growth in the medium-to-long term and facilitate access to capital for the region’s smaller companies,” says Rodriguez.

Previous People In The Trade

anish.puaar@thetrade.ltd.uk
+44 (0)20 7400 7105
