ALTERNATIVE
Emerging Investor

Issue 6 - April / May

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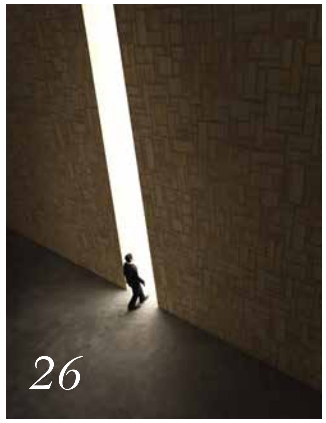

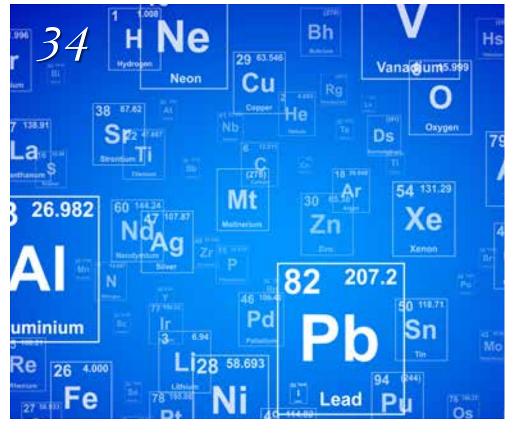

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LatAm Hedge Funds at Turning Point

After a pretty flat 2013, LatAm hedge funds could capitalize on high volatility for risk-adjusted returns in 2014. Between 2000 and 2008 the number of hedge funds in Latin America grew fivefold, while assets under management (AUM) went from less than US$5 billion in 2000 to over US$60 billion in 2010 (source: Eurekahedge). Compared to the exponential growth of the start of the millennium, the past few years have been rather flat, but experts still see bright prospects for the hedge fund industry in the region.

Victor Rodriguez, President and CEO of financial services company LatAm Alternatives, tells AEI, “In 2013 we’ve been repeating the pattern of low-ball activity, and because of this the curve of growth and changes of assets has been pretty flat. However, the region has been able to position itself as a very interesting emerging market with a mature history.”

“What we are going to see in 2014,” Mr. Rodriguez continues, “is that the rounds of due diligence that started after 2010 will start to materialize in commitment and allocation, such as managed accounts that major institutional players are willing to set up with hedge fund managers across the region to make sure they can control ownership and transparency. People will also start paying more attention to the returns of the hedge funds industry specifically compared with the volatility.”

“2013 was not a stellar year for the region, but I’m assuming that this was the necessary step to guarantee that after 2014 they have the best managers and the ability to show the global market that they have consistent returns in terms of risk-adjusted environments,” Mr. Rodriguez says.

He notes that the past year saw some smaller funds going out of business and others being created, particularly in Brazil, Mexico and Chile. “As soon as the local legislators start to set the presence of these alternative investments or risk-adjusted vehicles there will be a proliferation of more and more managers.”

Volatility

The main factor that will influence the success of the LatAm hedge fund sector in 2014 is volatility. In a more volatile market, institutional investors rely on hedge fund managers for their expertise in risk-adjusted returns.

“Big investment vessels will be able to really appreciate the active management of the portfolios and why they are paying these fees to hedge fund managers. It’s important to keep understanding that it’s not only about returns, it’s about certain costs – am I willing to take returns at any cost or do I want returns with a very controlled volatility in the portfolio, that’s the bottom line,” says Mr. Rodriguez.

As volatility hits and pension fund officers look for risk-adjusted low-ball liquidity portfolios, they might also be willing to convince regulators to invest in these managers, further boosting the sector.

“You will see a fantastic opportunity where these global asset managers will want to partner with local asset managers in order to be able to get some sort of allocation from the pension fund, but you’ve got to remember that in order for this to happen the legislator has to be able to change or modify some of the legislation again, which will be one of the triggering points,” he adds.

Volatility will also help hedge funds build up liquidity, a strategy that will attract even more investors.

Regional disparities

Because of its maturity, Brazil is still seen as a point of reference in the region. Now that major investors are willing to pull the trigger, they want a stable market in terms of managers, which is something Brazil can provide. Moreover, the upcoming World Cup and Olympics taking place in the country are expected to boost its economy, creating further investment opportunities.

However, because of the country’s low volatility and very tight links to China’s slowing economy, some investors have questioned its ability to deliver returns – fears that Mr. Rodriguez deems unjustified.

“I’ve been seeing people a little bit afraid of Brazilian behavior,” he says. “Brazil has been one of the most important economies in the world, and the global growth that we might see is going to start feeding the potential growth of China, which at the end of the day will fuel demand for Brazilian goods and services.”

“You have to be very granular in your research, but Brazil is full of talented managers, especially in Rio de Janeiro. I would encourage major institutional allocators to pay a trip to Rio in the first quarter of 2014 to get first-hand information about these potential opportunities,” he says.

Argentina has been very slow in terms of investor interest as well as fund creation, but possible changes in administration in the coming year could spur opportunities some people are already preparing for.

“You have to be aware that as soon as the internal political and economic policies change in Argentina the country will present a great opportunity to put some money to work, understanding that the result will not be immediate,” says Mr. Rodriguez.

He points out that the same thing could happen with Venezuela, as distressed prices in both countries will represent an interesting risk-adjusted opportunity in the long term. “If you are willing to cope with volatility in terms of the political situation in the country, you can have an interesting rate of return.”

With a tremendous number of opportunities projected in 2013, Mexico remains an attractive market for Rodriguez. “I remain completely bullish for the country in 2014. The managers that have been operating in the country have a unique talent and they know exactly how to make sure that they can exploit the country’s imperfections and deliver alpha, which is what major institutional investors are asking for.”

Finally, although Chile, Colombia and Peru have experienced various levels of performance, they should achieve more cohesion in 2014 via the Mercado Integrado Latinoamericano (MILA). “Up to a certain point everybody was very focused on their own country, but I think at the end of the year it will be very difficult to separate the region, and I’ve even heard lately that Brazil is interested in having an involvement with MILA,” says Mr. Rodriguez.

“What we have to do is unite and integrate more our countries’ business and stop creating division. Managers are seeing Latin America as a whole, and I don’t think they want to differentiate Mexico and Brazil from MILA; they want to invest in Latin America, and the region as a whole has a bright outlook, despite volatility challenges.”