

## Hedge Fund Management in Latin America



# Presentation Topics

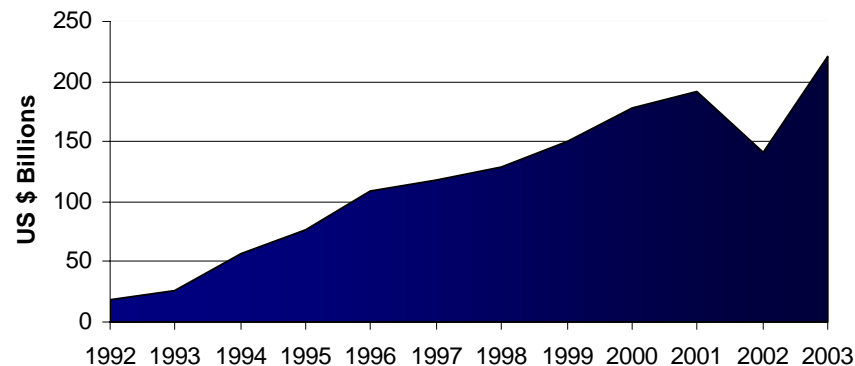
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- **Latam Asset Management Industry:**
  - Argentina
  - Brazil
  - Chile
  - Mexico
  
- **Due Diligence on Latam Managers – What is different?**
  
- **How to assemble an FoF of LATAM Hedge Funds**

# Latam Asset Management Industry

- Sharp growth of Fund Industry in Emerging Markets -> In 2003, its total net assets were more than 19 times the total for 1990
- Funds in Emerging Markets represent 5,70% of total Global Net Assets
- Latin America accounts for 1.90% of the total, with net assets of US\$221 bn in 2003

Mutual Funds Latin America - Total Net Assets



# Latam Asset Management Industry

- **Total Fund Industry (on-shore) AUM – USD bn / % GDP**

	1997	1998	1999	2000	2001	2002	2003	% GDP 2003
ARG	5,2	6,9	7	7,4	3,8	1	1,9	1%
BRA	108,6	118,7	117,8	148,5	148,2	96,7	171,6	32%
CHI	4,5	2,9	4,1	-	5,1	6,7	8,6	13%
MEX	-	-	19,5	18,5	31,7	30,8	32	5%

Source: IMF Working Paper WP/04/133

- **LATAM Off-shore funds (followed by Banque Safdié) comprise approximately USD 4.5 bn spread out over 83 funds**

# Argentina

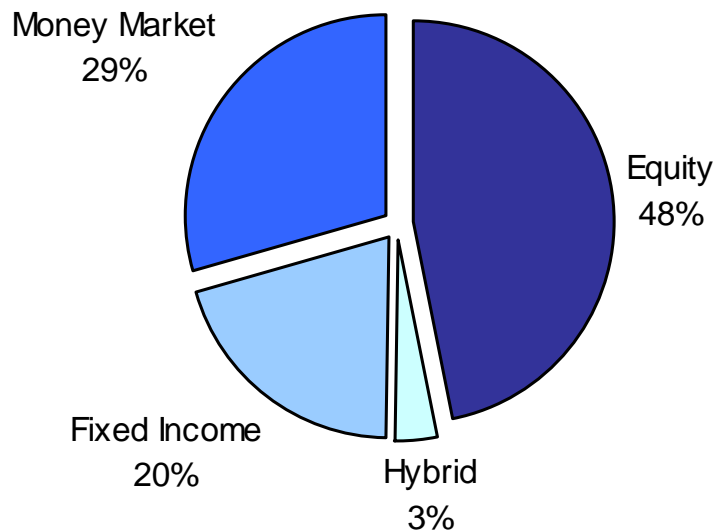
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- The total number of funds is not very large
- Not many prop traders in Argentina
- Liquidity is scarce on equities, derivatives and futures (small number of strategies)
- Short is difficult, although it is possible
- Due to a history of crises, clients seek investments in international assets or in very conservative funds
- USD denominated funds are very popular, but there are few off-shore funds focused on Argentinian assets

# Argentina

- The total AUM is approximately US 4.78 bn, spread over 192 funds (on-shore) – Aug/2006

## Segmentation by Fund - % Industry AUM



Source: Camara Argentina de Fondos Comunes de Inversion – Aug06

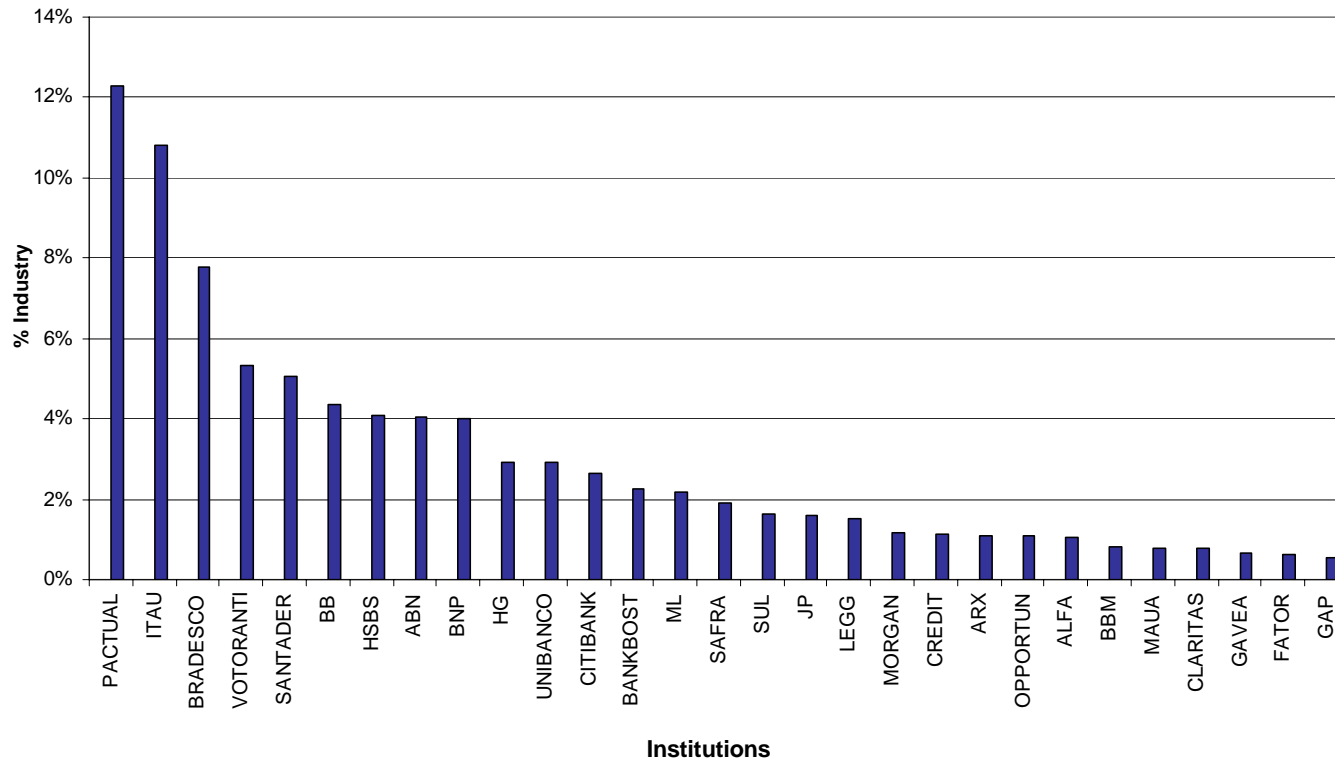
# Brazil

- Asset management industry (on-shore and off-shore) as % of GDP is bigger than in other LATAM countries
- Futures exchange is extremely liquid, but on a small number of contracts (in general, short-dated ones)
- Stock exchange and ADRs are highly liquid as well
- Huge number of IPOs and M&A activities work as a support for long & short equity strategies -> IPOs have grown 169% in H206 vs H205
- Daily NAV, industry is well regulated and transparent
- Line by line positions (on-shore funds) are available on the internet with 90-day delay

# Brazil

- In terms of distribution, industry is concentrated

Concentration Onshore Hedge Funds - By Institution\*

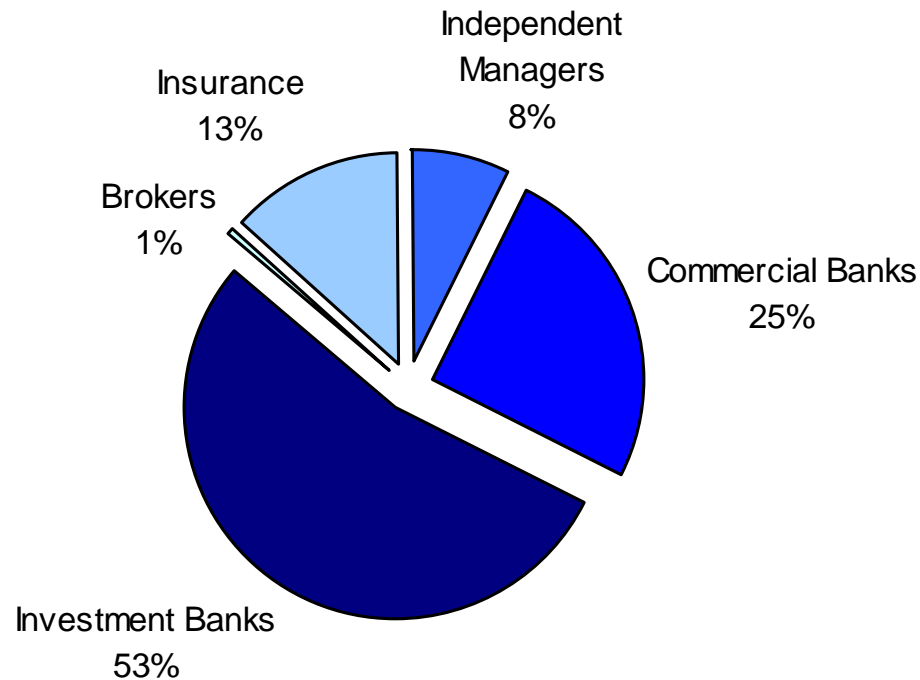


\* Institutions that represents more than 1% Industry AUM.

# Brazil

- Fierce competition from banks regarding professionals

## Segmentation by Type of Financial Institution

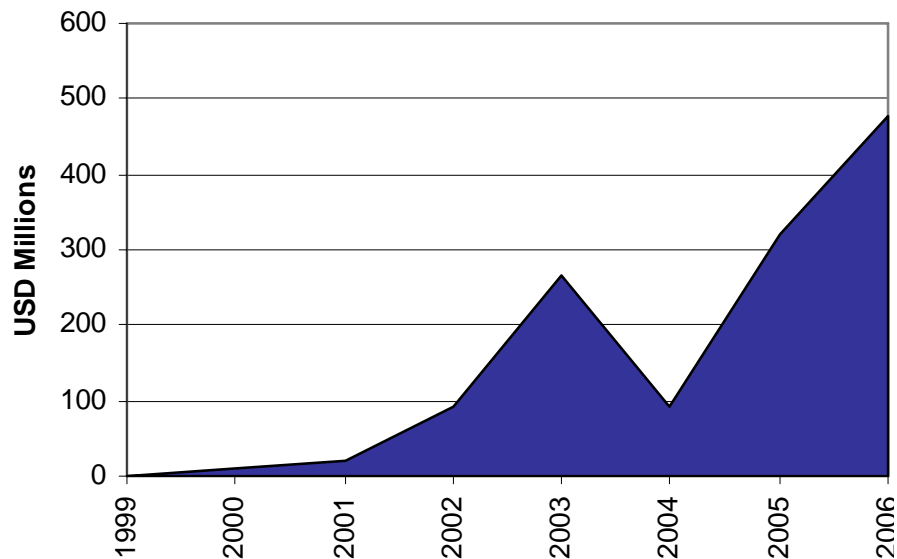


# Brazil

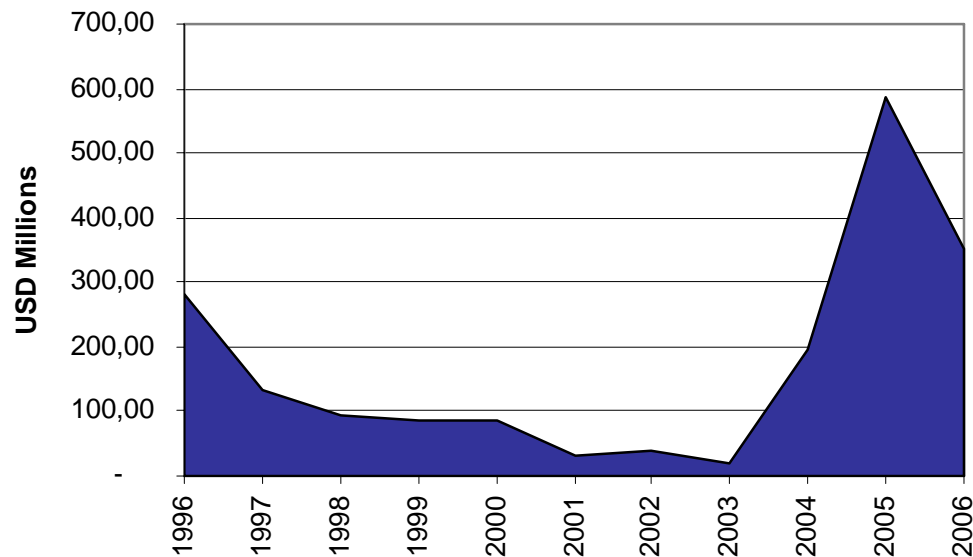
- Big fluctuations in AUM of onshore hedge funds, since few FoF managers control large % of assets
- Capability of retaining professionals can be jeopardized

AUM invested in onshore hedge funds – “multimercado”

Institution I



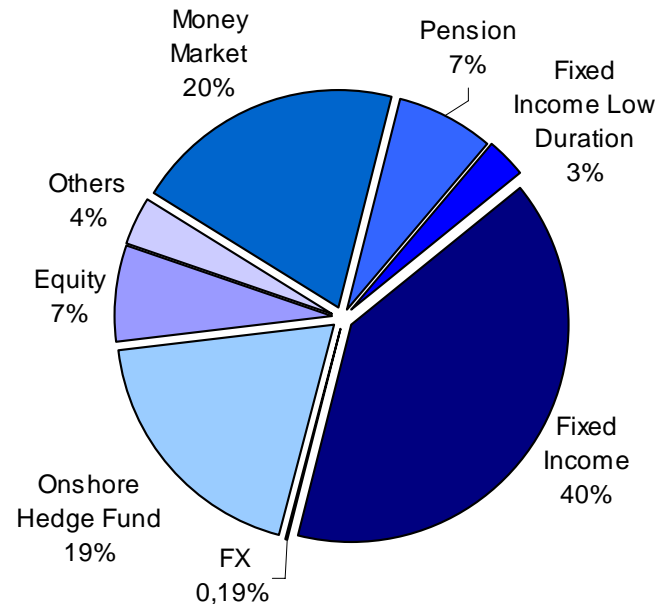
Institution II



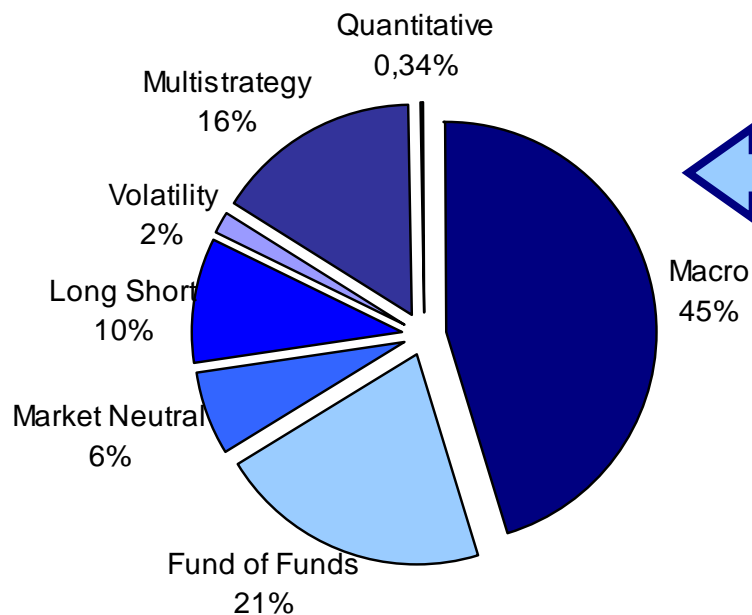
# Brazil

- Limited number of strategies

Segmentation by type - % of total fund industry



Segmentation by type - % of total on-shore hedge funds



# Chile

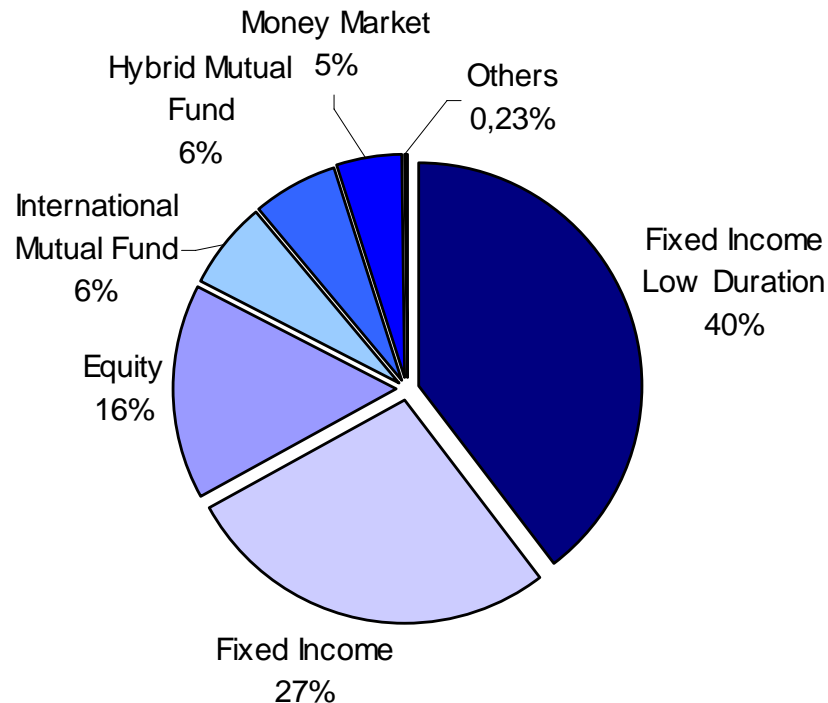
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- **Financial Market' s size has grown considerably since the 1982-1983 crisis and is responsible for a significant part of GDP**
- **In 2001, banks` total assets amounted 63.6% of GDP vs 21% in 1979**
- **The on-shore fund industry has also grown in the last four years, both in the number of funds and strategies**
- **The Stock Market is also huge -> In 2001, Market capitalization represented around 75% of GDP vs 25% in Brazil and 10% in Mexico**
- **Industry is very transparent -> clients can inquire at any time regarding management perspective and also receive the entire portfolio**
- **Daily NAV**

# Chile

- The total AUM is approximately US\$ 15.7 bn, spread over 786 funds (onshore)

## Segmentation by Fund - % total Investidores



Source: Asociación de Administradoras de Fondos Mutuos

# Chile

- In spite of the evolution in the Financial Markets, several negative points should be highlighted:
- Chile has one of the most illiquid Stock Markets of emerging economies -> Liquidity; turnover rate, measured as % of net inflow in the market, is roughly 9% as opposed to 45% in Brazil and 69% in Mexico
- Large part of financial assets are controlled by pension funds, which tend to be quite conservative
- Financial instruments and systems are not sophisticated -> Stocks derivatives, such as options, are not comprehensively traded due to regulatory and legal restrictions
- Offshore funds focused on Chilean securities are almost non-existent

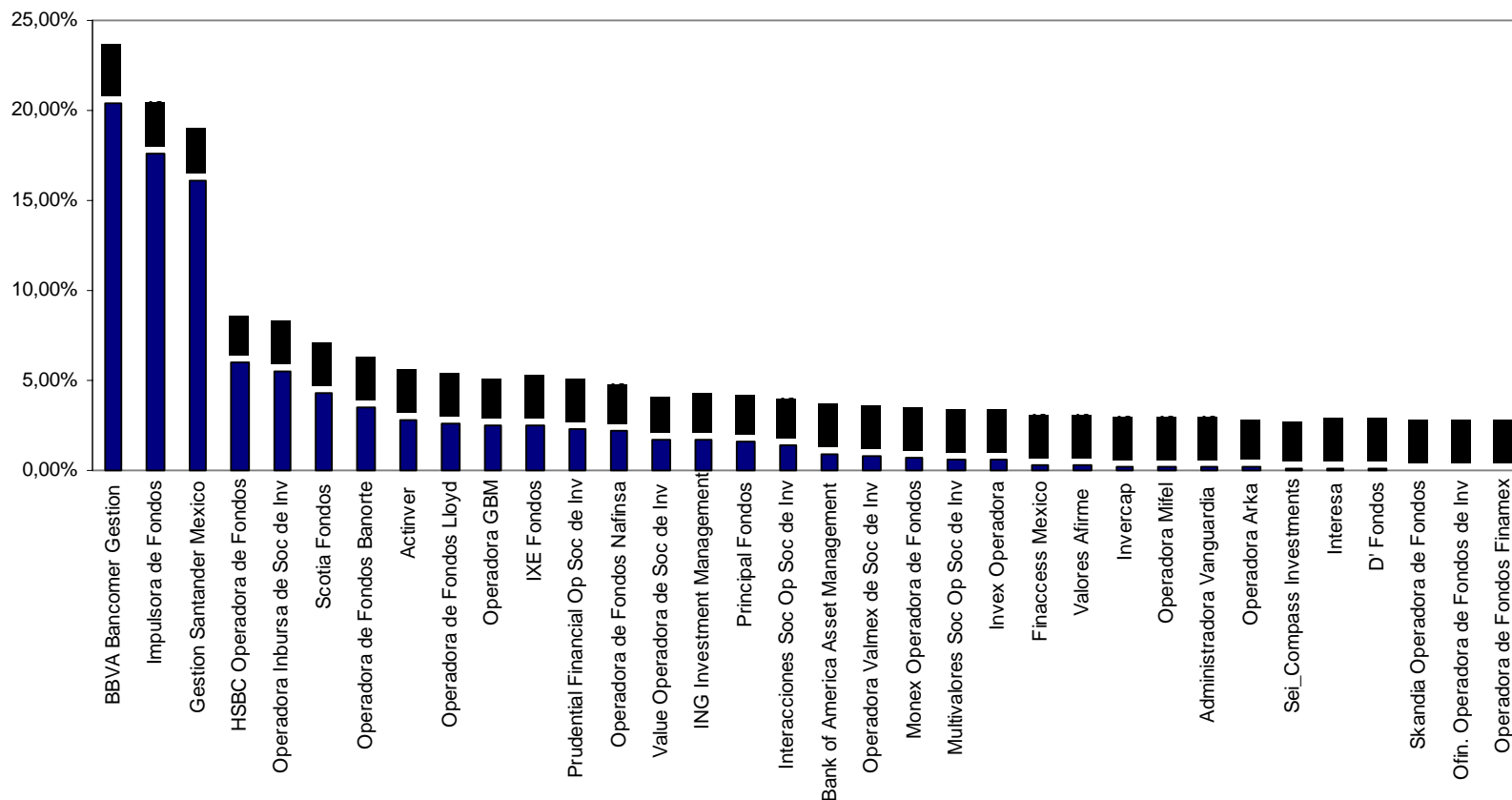
# Mexico

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- Fund industry represents approximately 6% of GDP (US\$54,1 bn) and has grown considerably over the last 5 years
- Good liquidity -> turnover rate, measured as % of net inflow in the market, is 69%.
- Futures exchange is very liquid (the sixth biggest in the world)
- Individuals are focused on fixed income instruments
- Large bulk of financial assets are controlled by pension funds which are very conservative
- In the recent past, Pension Funds were prohibited from trading sophisticated instruments, such as derivatives. Even today, they do not comprehensively trade because of a lack in cultural aptitude

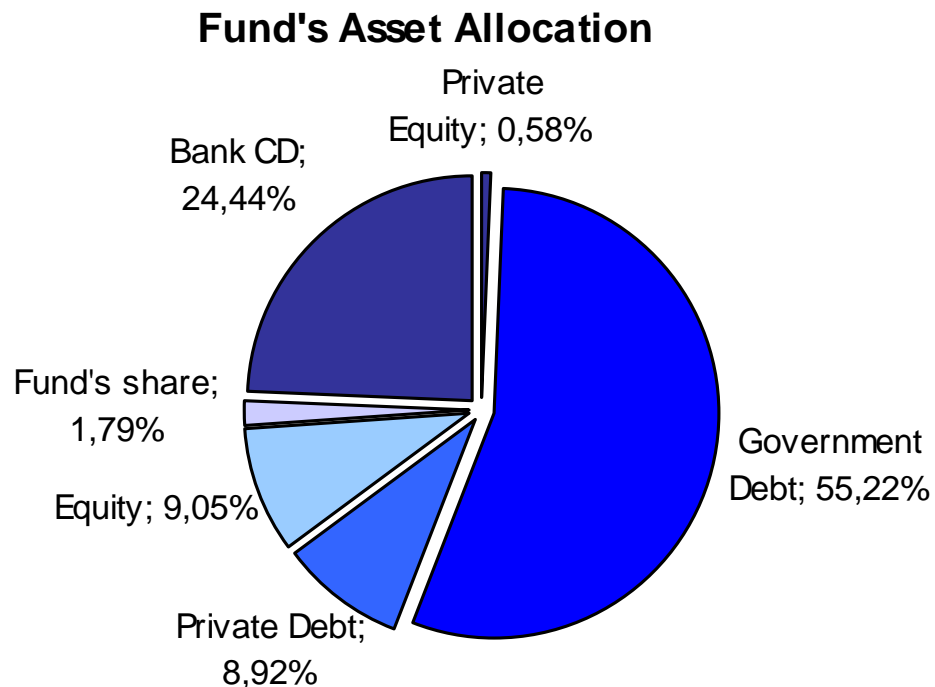
# Mexico

- Concentrated in terms of Institutions -> only 34 asset management companies



# Mexico

- Very limited number of strategies -> Focus is on fixed income
- There are 435 “Sociedades de Inversión” (on-shore funds) in the country, allocated as follows:



Source: CNBV – Jul06

# Due Diligence on Latam Managers – What is different?

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- Understand style
- Minimum track record of 18 months is desirable. Check alpha component. There are a lot of beta managers
- Only choose managers with solid corporate governance policies. Capability of retaining talent is key, since competition from prop desks and large asset management companies is fierce
- AUM analysis and monitoring is critical
- Because region is volatile, managers tend to be conservative
- Attention to MtM and pricing methodology
- Monthly reports need to be checked

# How to assemble an off-shore FoF of LATAM Hedge funds

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- **Core / Satellite Approach**
- **Seek out core managers with complementary skills and strategies**
- **Stick to the tried and tested**
- **Choose managers from different countries to improve diversification**
- **Concentration and dynamism are key**
- **Frequent top-down assessment of market conditions in order to balance chosen strategies**

# How to assemble an off-shore FoF of LATAM Hedge funds

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- **Avoid tail risk by taking care of non-liquid and asymmetric strategies**
- **Background check needs to be assessed in detail. It is not difficult, since everybody knows everybody**
- **On-shore industry is much bigger than offshore. Therefore, local funds track record needs to be analyzed and taken into consideration**
- **Best way to benefit from the opportunities: be an expert local manager**
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