

IS LATIN AMERICA OPENING UP FOR HEDGE FUNDS?



HFMWeek explores whether pension changes in some countries and growing private wealth will create new opportunities

BY SAM MACDONALD

Latin America continues to prove a hard nut to crack for hedge funds. Problems arise from the disparate nature of the region's policy on investment, and a lack of hedge fund knowledge from potential allocators. Legislation from country to country varies widely, and while average allocations remain at a decent level from some Latam quarters, there is still a large amount of assets that are not being accessed.

When *HFMWeek* last looked closely at Latam investors in 2014, there was a muted approach to hedge fund managers. That approach appears to have been maintained despite changes to legislation in countries such as Colombia where the path for pension assets to be invested in alternatives has been smoothed.

Advisory and capital-raising specialist Brunel Advisors partner and co-founder Tim Chamberlain says that the current economic climate in Brazil has meant there has not been any increase in hedge fund allocations from pension funds in the country in recent times. However, he says there is a growing optimism that the fall in interest rates will lead to more investors looking to hedge funds.

"Whereas on the pension side it has been very quiet, we have seen family offices increase allocations in certain situations," he says.

"Family offices are going about these allocations in a sophisticated fashion and will pinpoint which parts of their portfolio they are lacking. We have had people increasingly looking for market neutral lower beta strategies. These allocators will commit anywhere from 5% to 15% in hedge funds and sometimes more."

Chamberlain adds the most successful funds have a regional presence with senior, non-marketing staff, which lends itself to larger, more established organisations.

Previously there has been a heavy focus on Brazil as the main Latam allocator. But this seems to be changing with Brazil potentially contributing less and other countries coming to the fore. Man Group Latin America director Gadi Slamovitz says there is a heightening inter-

est in hedge funds from institutional investors elsewhere who are considering the asset class more seriously.

"We are seeing growing interest in hedge funds from South American investors, primarily from countries such as Colombia, Peru and Chile," he says.

"While historically the levels of hedge fund investment in the region have been low, particularly among institutional investors, we expect that gradual regulatory change and the development of the investment industry will mean that this will continue to increase over time."

INCREASE IN PRIVATE WEALTH

Private wealth in Latin America achieved double-digit growth in 2014, rising by more than 10% to almost \$4trn, according to data from Boston Consulting Group (BCG). That growth was notable in Colombia, which was up 10%. BCG says Latin America's private wealth will reach an estimated \$7trn in 2019, bringing the region closer to the Middle East and Africa.

While Latin America represents only about 2% of global private wealth, its share of total offshore wealth is more significant -11% in 2014, and expected to grow to 14% in 2019.

In June, Trident Fund Services launched a South Florida and Latam funds desk in Miami, following sustained growth and rising interest from Latam fund managers and family offices. "I think that demographic of Latam hedge fund investors is now extending beyond Brazil and we now see additional interest from places such as Peru, Colombia and Venezuela. There are now large amounts of South American capital raised in South Florida," Trident global director Thaluis Hecksher says.

As of this year, Colombian pension funds are allowed to invest in alternatives, including hedge funds. But little has been done so far. The move paves the way for around \$10bn to go into alternatives.

As of November, Colombian pension funds controlled around \$49.8bn in total assets. While the size of new allocations to hedge funds by Colombian pension funds remains to be seen, industry figures say there is a tangible opportunity for some managers.

Colombia runs a tiered pension regime broken down by risk tolerance into three buckets with the lowest risk category prohibited from investing in hedge funds. The country's Moderado (moderate) pension bucket is allowed to allocate up to 1% of AuM into "restricted assets", which includes hedge funds and non-investment grade fixed income. However, the current allocation to foreign issuers of equities and alternative investment stands at 32%, suggesting there is an opportunity for hedge funds once the new legislation beds in.

The higher-risk Colombian pension bucket, Mayor Riesgo, permits a 4% allocation to restricted assets and currently has a 50% allocation to foreign issuers of equity securities and alternative investments. Perhaps predictably, the moderate pension bucket in Colombia is the largest of the three. While there is an initial caution around changing their investment models at the moment, there is hope that pensions will look carefully at hedge funds and increase their awareness of the sector.

Latam investment and advisory firm HMC Capital Colombia head Diana Roa says the change in the investment regime for Colombian pensions opens the door to foreign hedge funds.

"There is a significant opportunity for hedge fund managers to raise capital when you look at current portfolio composition of a system that manages approximately \$50bn and has no allocation to hedge funds, even though the new regime only allows for 1% of portfolio Moderado to be invested in this type of asset class," Roa says.

Peruvian pension funds have a total value of around \$40bn and are allowed to invest in hedge funds, also dependent on their risk profile. Peru splits hedge funds into three risk categories: low, moderate and high. While low-risk pension strands are not allowed to invest in alternatives, moderate risk funds can allocate up to 4% of their assets, while high risk buckets can put as much as 6% of their AuM into hedge funds. On top of that, pension funds must demonstrate to the regulator their ability to understand and to evaluate hedge funds prior to making an investment.

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IN TERMS OF ACTUAL HEDGE FUNDS, SOUTH AMERICAN INVESTORS ARE LOOKING FOR BIG NAMES, BIG BRANDS AND BIG SIZE

” KEITH MAHON, APEX FUND SERVICES

SHIFT AWAY FROM HEDGE FUNDS

According to data from Preqin, there are 29 active hedge fund investors based in South America, a drop from 36 in 2015. The figures also show that the average allocation to hedge funds by Latam investors is also down. Last year the average allocation was 14.8% of overall assets. This is down to 11.2%, Preqin data shows.

The fall could be explained by a number of factors, including a change in approach from investors who now increasingly favour Ucits and liquid alts funds over off-shore vehicles. Latam specialists say there is an increasing move away from hedge funds towards liquid alts,



driven by private banks, largely due to the enhanced liquidity offered.

Frank Pauls, a specialist in Latam alternative investors and former head of alternative fund distribution in South America for UBS Investment Bank, says there has been a shift towards Ucits.

"There is a move towards Ucits structures because the daily/weekly liquidity is attractive to investors and the private banks are driving them into liquid structures.

Pauls adds that allocators are also drawn to private bank platforms because they feel more secure with larger names that banks have already vetted.

"Managed account platforms backed by big global banks are popular in South America because of the security and the fact that the banks have already done due diligence on them, which gives them reputation and additional transparency," he says.

Miami hedge fund Noctua Partners, which runs an emerging market credit fund focusing on Latam debt, says investors in the region are unlikely to commit directly to hedge funds. "The culture you see in the US and Europe where individuals and institutions invest directly in hedge funds is not that common," Noctua co-founder Martin Guyot explains.

"In certain countries like Brazil, hedge funds products and strategies are offered throughout local platforms and have become quite popular. In Chile, the asset management is very well developed, but hedge funds as a strategy per se are not that common, the focus is more on long-only or index-based strategies."

Apex Fund Services managing director Keith Mahon, who specialises in the Latam region, says investors are looking to access high yield fixed income products, but adds that investors are looking for recognised, blue chip brands and track record.

"There is a lot of interest in fixed income products where they can access a regular income from their investments and I think that is set to continue," he says.

"There is a rolling interest in debt purchases and lending funds which are focused on US lending which generate a high yield."

The presence of larger managers such as Third Point, Paulson and Och Ziff in the region underlines the necessity of having a recognised name and reputation to attract assets from emerging markets.

"In terms of actual hedge funds, South American investors are looking for big names, big brands and big size," adds Mahon.

"It is not a market that is going to give many opportunities to small or emerging managers in the short and medium term going forward." ■