



Roundtable discussion

swissHEDGE regularly invites reputed hedge funds to a discussion on their area of expertise. This time, we have invited three prominent Latin American hedge funds to share their views on the local investment environment.

Maua Investimentos

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Fund: Maua Brazil Fund
Representative: Luiz Fernando Figueiredo, President of the Investment Committee
AUM: USD923m

Copernico Capital Partners Ltd

Fund: Copernico Latin America Strategic
Representative: Ricardo S. Maxit, Portfolio Manager
Firm AUM: USD290m

Greylock Capital Management, LLC

Fund: Greylock Emerging Market Equity
Representative: Lucia Skwarek, Portfolio Manager
Firm AUM: USD800m

Q: Why is Latin America attractive for hedge fund investing ?

MAUA: Latin American countries have gone through an adjustment of their external accounts – helped by a benign global environment – that has strongly reduced solvency risk across the region. On top of that, most countries adopted prudent fiscal policies as their main macroeconomic framework. These factors allowed for a deepening of local markets in the region, especially as external debt has been reduced drastically. Markets became more liquid, the duration of domestic debt has increased markedly, and appetite of foreign institutional investors is at all-time highs.

COPERNICO: The region offers positive secular trends with sharp cycles. In the last few years, macro stability and improved credit quality in some countries have allowed for long-term investments. Moreover, we are in a corporate environment of increased consolidation amongst a back-drop of players that in many cases are forced to take non-economic decisions due to market and resources constraints. In the last 18-24 months, fundamentals have improved substantially. Asset prices followed suit. Therefore, it is harder to find clear investment opportunities in the most liquid and crowded markets. However, we believe that today there is an opportunity to go down the liquidity spectrum by investing in both public and private assets that are less correlated with the market.

GREYLOCK: As the countries become more open and corporate governance improves, hedge fund-style investing becomes easier every year. For the larger countries, there are a number of ways to go short, via indices or futures locally, or via ADRs listed in New York. There are also different pools of investors who might take very different valuation views on a particular company – from local investors to professional emerging market investors to global investors. Valuations are attractive as lower interest rates, lower inflation and lower political volatility make projecting economic and company performance easier than ever before.

Q: What is your macro economic outlook for Latin America as a whole? How relevant is the macro environment to the management of your fund?

MAUA: Despite much sounder external accounts and reduced dependence on external financing, most Latin American countries rely deeply on the positive global scenario and supportive commodity prices. Hence, should there be a severe downturn on global economy (especially in the US and China), the region will suffer. We do not

expect such a reversal for 2007. A softer, more balanced global economy should be seen as positive for the region. One should keep in mind that the shift of some countries to populism with prudent fiscal policy is worrisome, especially in light of softer commodity prices.

COPERNICO: Macro is of high importance for us, since Fed decisions or abrupt liquidity contractions can affect asset pricing considerably. However, the bottom-up approach is even more important as we tend to have several stories in the portfolio which have a low correlation with the market, and that are mainly driven by specific catalysts. We believe the macro economic outlook for Latin America to be a good one for 2007. Liquidity will remain high, and stable if not surging commodity prices will make a great setting for the region. Also, there is a growing consensus that Fed Funds will remain at these levels, contributing to a favorable environment for global emerging markets.

GREYLOCK: The Macro environment for Latin America has always been key for any manager. For us, the macro environment drives our country allocation decision, and then the actual stock picking is driven by valuation. Buying cheap stocks in improving economies should always outperform those in deteriorating economies. The “country call” always matters as the variety and frequency of Latin American crisis can remind us. But the macro view is not just important for foreign investors, it is extremely important for local ones as well. One of the reasons that reserves have been built is because local investors are comfortable investing in their home countries for the first time in years. Historically, the busts were driven by local capital fleeing the country at the first sign of instability. Peru is a good example of how local investors, not foreign ones, have been able to build up investment in the country for the first time in decades. Our macro outlook is that the big countries, Brazil and Mexico, have solid macro foundations now, with very low risk of backtracking to old-style policies. Venezuela and Argentina however, are more complicated, with a higher risk of inflation, political problems, etc.

Q: To what degree is “being local” a competitive advantage?

MAUA: As the markets get more breadth and become more developed, local issues should start to dominate risk appetite. In the last 10 years, the relevance of global themes over local themes has been obvious, but we expect this pattern to reverse going forward. On the equity market, it seems that being physically close to the companies helps our research capabilities and improves our understanding of earnings.

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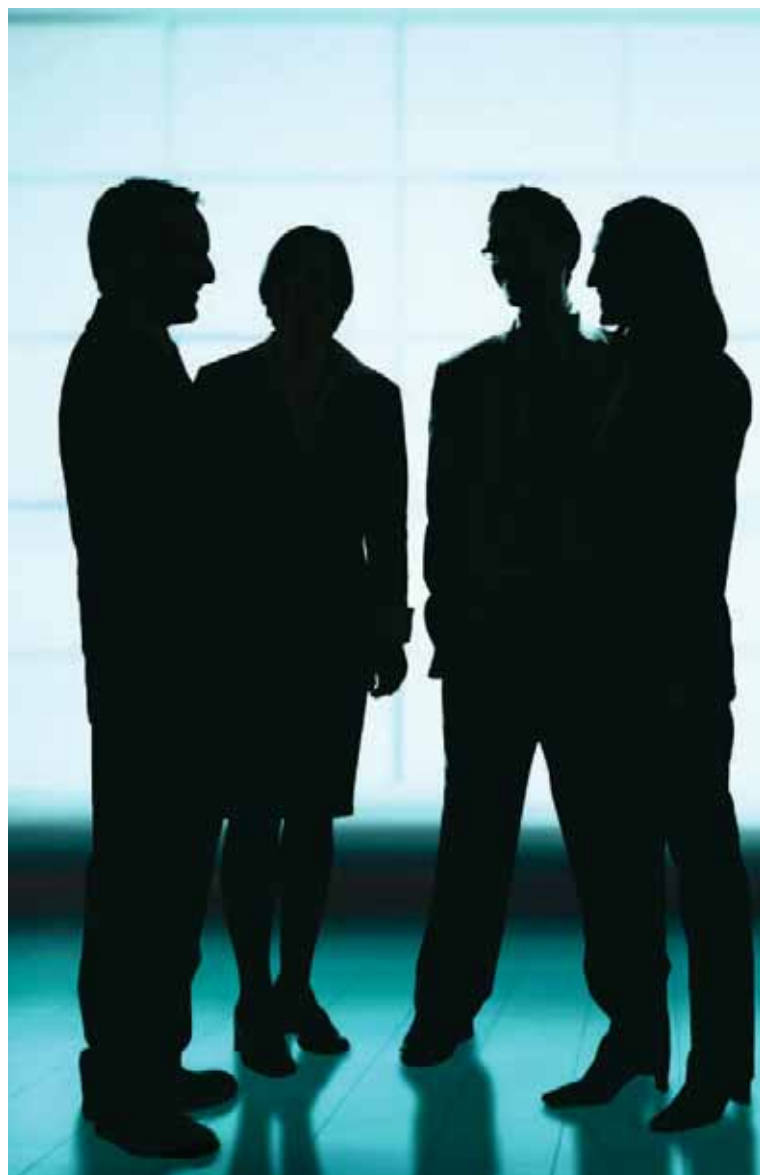
COPERNICO: For most liquid assets, trading in the region has become a commodity. For this type of investment strategy, we believe that the advantage of being local has diminished. However, there are some other opportunities more related to credit or special investments where we believe that being local provides an edge and gives more access to certain deals where locals are always the first call. GREYLOCK: Being local can be both a curse and a blessing. It can be a curse as you can get “too native” and lose your objectivity and lose sight of what global markets are doing. It can be a blessing because you will have a good idea of what local investors are thinking and feeling. But Latin America is a big place, and each country is different. So, a Brazilian trading Mexico from Sao Paolo is no more local than someone sitting in New York. I do think it will be useful for an organization with local people on the ground in each country. It is also useful for small and medium cap strategies, as well as accessing local investor flow from the growing pension funds.

Q: What are some of the unique and interesting investing opportunities that are available in Latin America?

MAUA: Our top pick is the equity market in Brazil. As we expect real interest rates to continue to drift lower, the equity market is supposed to increase both in valuation and in number of listed companies. In addition, local investors hold very little of equity on their portfolios, and a shift should be expected during the next 5 to 10 years. Consumer credit in Brazil is another market that has increased over the past couple of years, and we expect this pattern to intensify going forward.

COPERNICO: There are plenty of examples such as factoring in Brazil, Argentina, Mexico and Uruguay; refinancing and restructuring stories in Mexico and Argentina; and interest rate swaps in Brazil betting on a drop of medium-term rates. While there will be a few macro plays, it won't be as exciting as previous years, as micro stories in general will be the main investment themes for the next 1-2 years.

GREYLOCK: Infrastructure in Brazil could be an exciting theme over the next years. Brazil has been building up reserves, expanding payments of social services, but doing very little to invest in its inefficient and aging infrastructure such as roads and railways. In Mexico, any opening of the electricity or energy sector too will be interesting. Chilean companies that do business in Argentina are interesting as well, as those assets have been considered nearly worthless since the crisis, but they today have enormous recovery potential.



Q: How important are the global economies to Latin America? Which ones have the most pronounced impact and why?

MAUA: The relevance of global economies to Latin America is still notable, but we do expect it to decline over the next 5 years. US and China are definitely the most relevant, especially in light of commodity prices. It is worth noting that, given the improvement on the solvency of the region, the impact of reduced liquidity and/or lower commodity prices is smaller today than it was 5 years ago.

COPERNICO: Global economies are very important to Latin America, since they are the liquidity providers and at the same time very important commodity buyers, especially of soft commodities. US, Europe, China and India are the most important global economies that have a significant



impact in Latin America.

GREYLOCK: The health of the global economy is important to every Latin American economy. The reserve build up has been due to global growth spurring commodity and manufacturing exports and rising global liquidity. Not even a closed economy like Venezuela's is immune to a slow-down in global growth. The US and China are probably the economies with the most impact on Latin America. China's growth has increased commodity demand globally, and puts Brazil at risk should that growth slow. Mexico is particularly sensitive to US growth and will suffer if US growth is below expectations. That being said, there is a lot that countries can do in order to insulate themselves from a downturn in global growth by instituting reforms on labor, pensions and taxation.

Q: Given that Brazil is the largest economy in South America, what other countries present investment opportunities? Why?

MAUA: Mexico, Chile and Colombia are the other countries where we see good opportunities. These markets have good liquidity (especially Mexico) and their governments have shown respect to contracts and orthodox policies; they present a stable macroeconomic framework.

COPERNICO: Besides Brazil, we believe that Mexico, Chile and Argentina are the other main investment markets in the region. All these countries provide relevant opportunities due to improving local economies, booming commodity markets and massive inflows of funds for all emerging markets. Additionally, there are a number of countries that provided very interesting opportunities in the past and we are certain that they will continue to do so

in the future. Some of them are Venezuela, Dominican Republic and Uruguay.

GREYLOCK: Mexico, in terms of the stock market, is at the top of being reasonably priced. Argentina could be quite interesting if the growth could be harnessed into new investments. Earnings recovery continues in Argentina and the companies are quite adept at maneuvering around the government controls. Peru is interesting as well, as domestic demand should continue to grow, but the market seems quite expensive. Chile is a country I like a lot, as valuations seem reasonable if you look beyond p/e's which are often distorted due to accounting differences with the rest of Latin America. Also, Chile is a good "port in the storm" should the rest of the region trade down.

Q: What do you see as major risks in investing in Latin America? What do you consider as the single most risk?

MAUA: The shift of some countries into populist-like governments is the single most important risk. These governments have been acting on a market-friendly way, but we're not so certain that they will react accordingly should there be a correction on commodity prices and a reversion on risk appetite over the next 12 months.

COPERNICO: We believe some risks are: liquidity, inflation and economy growth concerns in the US that can cause further moves in interest rates there, local currencies weakening vis a vis to the US dollar, a sharp fall in commodity prices—especially those actively traded in Latin America—and a deterioration of fundamentals in the region. We believe one of the most important risks in the short to medium term is a reduction in global investor liquidity, since it would affect asset pricing and could force

some capital calls in Latin American asset managers. Besides this short-term risk, we believe that inflation and economic growth concerns in developed markets, especially in the US, are a major risk. It is worth mentioning that today Latin American markets are better prepared to handle external events as the ones mentioned above, due to improved fundamentals across the board.

GREYLOCK: The single most risk: lack of reform. The poor people in these countries have been very patient waiting for the global growth to trickle down to them in the form of better education, better jobs, less corruption, etc. If there is no progress soon, you may see situations like Venezuela, Ecuador, Bolivia, where old-style populism is attractive once again. Both Mexico and Peru were extremely close calls – Mexico but for the lack of 20,000 votes could have seen a very different political landscape than today.

Q: There have been frequent market crisis in emerging markets, particularly Latin America. Why is Latin America prone to such events and do you see one on the horizon?

MAUA: In the past, Latin American countries have had very weak debt profile, high dependency on external financing and commodities were on a bear market. This situation started to reverse by late 2002, after China entered the WTO. Today, most countries in the region have close to

zero dollar denominated debt, issue in domestic currency on the offshore markets, have increase their foreign reserves, and maintain a prudent fiscal policy. It is fair to say that the causes of crisis in the past have been drastically reduced, that sudden stops in external financing are no longer a risk and that these countries are in a much better shape to withstand market turmoil or a change on the benign global environment. Nevertheless, we are particularly cautious on the marked shift towards populism and potential impacts on the market friendly policies adopted so far. It is noticeable that the region presents a rate of growth much lower than other emerging regions. The temptation to promote more short-term growth might jeopardize the good work that has been done so far.

COPERNICO: Latin America has suffered frequent market crises in the past, which we believe have been due to a combination of factors such as poor fiscal policies, lack of structural reforms, fixed exchange rates, and infrastructure investments driven by market cycles rather than economic cycles. We believe that in the medium-term horizon, while a crisis can happen again, it is very unlikely that it will have the strength of previous regional crises such as Mexico's 1994, Brazil's 1999 and Argentina's 2002.

GREYLOCK: Latin America continues to have too many poor people and just a very few rich people. The lack of political/judicial and social infrastructure leads to corrup-

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tion that the governments can't stop even when they want to, as evidenced by the level of crime in Mexico and scandals in Brazil. The lack of confidence in the government leads to a run on the currency and distrust of investors. I don't see a crisis brewing in any particular big country on the horizon, but again, investment in the poor population's well being must begin to occur soon or we will be confronting that kind of crisis again.

Q: What sort of specific knowledge should investors have to invest in Latin American hedge fund managers?

MAUA: Despite the good performance of most assets on the region over the past 3 years, investors should be aware that volatility is a relevant variable and that liquidity – even though much higher today than 3 years ago – is still an issue when markets get shaky. In addition, there has been an increase in duration on most local interest rate markets,

which should add volatility on corrections.

COPERNICO: Besides the standard due-diligence process that an investor must conduct with any hedge fund manager in the world, we believe that they should also understand the local hedge fund manager's real edge in the region, and what separates that specific manager from all others in terms of deal sourcing and risk-adjusted returns. GREYLOCK: History. It is extremely important to know where these countries have been to understand where they are today and how they are going to have to change in the future.

Q: How do you see the Latin American hedge fund industry evolving in the next 2 to 3 years?

MAUA: The fund industry in Brazil is the most developed on the region and we believe it will continue this way over the next couple of years. Local hedge funds will become the major risk-takers, as there should be a shift on portfolio allocation of individuals, from mutual funds into hedge funds (macro and equity hedge funds). We firmly believe that the equity market's relevance will increase and that local players should be prepared for this shift.

COPERNICO: Right now there are approximately 130 Latin American offshore funds that are based in Latin America. The lion's share of them is based in Brazil, with a few in Argentina and close to none in Mexico and Chile. A majority of these funds focus only on Brazil, mainly due to their geographical location. Besides these funds, there are also a number of managers located in the US and Europe that have a portion of their funds dedicated to Latin American assets.

In the next 2-3 years we think that more than a few players based in the region will emerge (in 2006 we have seen some of them settling in different countries of the region), but with renewed competition coming from US and European managers who are likely to broaden their Latin American strategy as part of their investment mandate. Moreover, a specialization in the region is going to take place, with new niche-markets and standardized asset classes. This will generate more competition in the medium-term.

GREYLOCK: It is evolving into a market where the investor base is no longer exclusively international. The professional local investor base will grow, deepening the capital markets. That local investor base will require the same sort of products that investors in developed countries demand, such as hedged investing, derivatives and structured products. The companies themselves will continue to access capital and broaden their ownership, so there will be more stocks available and more industries will develop. I can imagine new sectors such as health care and transportation emerging.