



Opalesque Round Table

BRAZIL

Introduction

Dear Reader,

Brazil-based hedge fund managers, fund of funds and family office believe the country is now getting ahead of the pack compared to its emerging market peers.

Brazil has enough foreign reserves to pay down all the public foreign debt. This is the first time the country is in such a condition. In the last crisis in 1998, China was the only country which had sound fundamentals and they could maneuver their monetary policy to keep the country growing, despite the fact that all of the economies in the region were going down by 10% or 15% in GDP. Managers believe that this time Brazil has exactly the same characteristics.

Highlights from the Opalesque Brazil Roundtable, which took place Oct. 22nd 2008 at the Sao Paulo office of Bulltick Brokerage, who also sponsored the event:

- Hedge fund managers forecast 3% or more growth in Brazil - will the money flow back into the country? Which strategies will benefit first?
- No systemic risk: banking and corporate sector unleveraged, efficient regulation ensures banks are well capitalized
- But: while retail lending is still completely open and set for a 10-15% growth - no bank has reduced the credit lines and the amount of money available for retail investors, corporations are in a classic liquidity trap with funds being locked in at the bank level
- Brazilian family offices and FoFs expect a surge of new managers to set up shop to profit from current dislocations
- The global hedge fund industry is now a buyers' market and no longer a sellers' market. What does this mean for managers and investors?
- The concept of hedge funds as "absolute return" vehicles or "alpha machines" has been disproved. What is the future?
- A continuation of the liquidity discussion (see our NORDIC Roundtable)

The following experts participated at the Roundtable:

1. Luiz Felipe Pinheiro de Andrade, managing director of [UAM](#)
2. Mauricio Levi, founding partner of [Fama Investimentos](#)
3. Luiz Fernando Figueiredo, founding partner of [Mauá Investimentos](#)
4. Walter Maciel, partner, [Quest Investimentos](#)
5. Sérgio Goldman, [Bulltick](#) partner and head of equity research
6. Patrick de Picciotto, partner of [M Square](#)
7. George Wachsmann - partner at multi-family office [BAWM Investments](#)
8. Otávio de Magalhães Coutinho Vieira, Director of Investments at [Safdié Private Banking](#)
9. Antonio Martin, partner at multi-family office [GPS](#)

Enjoy "listening in" to the Opalesque Brazil Roundtable!

Matthias Knab
Director Opalesque Ltd.
Knab@opalesque.com

HISTORY OF HEDGE FUNDS IN BRAZIL

Latin America accounts for 8% of the world's GDP and 8.5% of the world's population. The majority of Latin American hedge funds are focused on Brazilian markets, where most of the assets and managers are based.

Latin America is still under-represented within the global hedge fund industry. With an estimated US\$45bn of assets and 169 hedge fund managers, it represents less than 2% of the total universe. However, contrary to most other hedge fund jurisdictions, Brazil has developed a diverse and well regulated onshore hedge fund industry.

About 75% of the hedge fund assets run by Brazilian managers are in the multi-mercado funds, the onshore vehicles. According to GFIA, ANBID and Eureka-hedge, 87 Brazil based hedge fund firms manage 225 onshore funds with \$29,399m of assets. Meanwhile, 43 Brazil based hedge fund firms manage 68 offshore funds with \$10,187 m of assets (as of end July 2008).

Strategy breakdown for all (on and offshore) Brazil hedge funds, as of August 2008 in % of assets:

- Macro/multistrategy: 50.4%
- Long-short equities: 23.0%
- Event-driven: 14.7%
- Fixed income: 9.5%
- Relative value: 1.7%
- Others: 0.7%

TRANSPARENCY AND REGULATION

Brazil's onshore hedge industry was started by the mutual funds industry, which means that a very transparent and regulated industry has been created. Many funds publish their NAV on a daily basis.

Participant Profiles



(left to right)

Matthias Knab, Walter Maciel, George Wachsmann, Sergio Goldman, Otávio de Magalhães Coutinho Vieira, Antonio Martins, Patrick de Picciotto, Mauricio Levi, Luiz Fernando Figueiredo and Luiz Felipe Andrade

Introduction

Sergio Goldman
Bulltick Capital Markets

My name is Sergio Goldman, I am responsible for the equity research product at Bulltick for Latin America. So I am more a service provider to the asset management industry rather than a direct player or asset allocator.

Patrick de Picciotto
M SQUARE

My name is Patrick de Picciotto, I am a partner at M Square. We are an asset management firm with two distinct investment divisions: one focused on funds of hedge funds and one focused on Brazilian equities. On the fund-of-funds side, we manage a Global and a Latin America portfolio and, on the equity side, we have a dedicated team that invests in Brazilian stocks (through long term, value oriented vehicles). We manage approximately \$600 million and are quite uniquely positioned in Brazil, given our expertise in both local equities and hedge funds abroad

Antonio Martins
GPS

My name is Antonio Martins, I'm a partner at GPS. We are a multi-family office that provides investment advisory and asset allocation both in local and in international markets for high net worth individuals and families. As of today, we have more than \$4 billion in assets under advisory, invested in alternative, liquid and illiquid assets.

**Otávio de Magalhães
Coutinho Vieira**
Safdié Private Banking

My name is Otávio Vieira, I am Director of Investments at Safdié Private Banking. We are wealth managers and run a fund-of-funds focused on Latin America - an offshore product - but our main focus is onshore asset allocation for private clients. We are a wholly owned subsidiary of the Bank Safdié in Geneva, that has over \$7 billion under management.

George Wachsmann
BAWM Investments

My name is George Wachsmann, I am a partner at BAWM Investments. We are a multi-family office. Our clients' portfolios range from fixed income in Brazil all the way up to hedge funds offshore. We render advisory services both on liquid and illiquid investments, as well as on the relevant legal aspects involved.

Luiz Felipe Andrade
Unibanco Asset Management

My name is Luiz Felipe Andrade, Managing Director of Unibanco Asset Management. We are a large asset management company in Brazil, with over \$25 billion in assets under management in all kinds of products - long-only, hedge funds, and also fund-of-funds.

Walter Maciel
Quest Investimentos

My name is Walter Maciel, I am a partner at Quest Investimentos. We are an independent hedge fund based in Brazil. We have \$500 million under management in long-only, long-short, and macro strategies. We also run one offshore macro fund that has a four-year track record.

Mauricio Levi
Fama Investimentos

My name is Mauricio Levi. I am a founding partner of Fama Investimentos, an asset management house focused on Brazilian equities; established in 1993. We currently manage approximately \$1 billion, from domestic and foreign investors, in both long-only and market-neutral funds. Our approach is bottom-up, based on fundamentals and activism in the companies we invest in. We always try to get hold of seats in the management and audit board. This year we are directly or indirectly sitting in 12 management boards and 16 audit boards.

Luiz Fernando Figueiredo
Mauá Investimentos

My name is Luiz Fernando Figueiredo, I am the founding partner of Mauá Investimentos, a Brazilian asset management company that focuses on strategies in Brazilian assets, fixed income and equities. We have around \$400 million under management. Our company was founded in the beginning of 2005.

What is your analysis or projection on the further economic development of Brazil and what does this mean for your hedge funds and for your hedge fund strategies?

Luiz Fernando Figueiredo

Well, for the first time we are not the guy responsible for this crisis. We are more a victim or suffering from the consequences of this global financial fall-out.

In my view, we see a very important deceleration of our economy. I am not sure if it will be at the end a recession or not; probably no, our forecast for next year is 3% growth in Brazil, which is different from what you see in other countries.

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Probably, this crisis will not be a big trauma for the Brazilian asset management industry, but it will hurt a lot. We will suffer, but not so much as we may see it in other countries. I think there will be a trend where investors will sort of go back to the basics. Investors will not continue to invest and take risks as they used to before the crisis. They will be much more cautious and only a fraction of the previous volumes will be invested in riskier assets.

In Brazil, we did not have any major problem with any asset management firm here. I believe when things get calm abroad, we will see that investors will come back step-by-step into equities and funds with a low volatility profile.

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Medium and long-term, I am still optimistic on our industry; I believe most players are demonstrating risk management capacity. In Brazil, we did not have any major problem with any asset management firm here.

Our industry is relatively new, and therefore we don't have such highly volatile products. I believe when things get calm abroad, we will see that investors will come back step-by-step into equities and funds with a low volatility profile.

I believe that Brazil could come out of this crisis stronger than before in terms of the global perspective. Our debt to GDP ratio is decreasing, it now stands at approximately 38% and we will have growth of about 2% in 2009 which puts us in a very different position from countries like Italy that has over 100% debt to GDP and it will grow zero next year, or even negative.



Other than that, I don't think Brazil is now suffering a confidence crisis. Our financial system is un-leveraged and very well regulated. Systemic risk is very low. I believe that when the credit crunch and unwinding process end, Brazil can also benefit from the global flow of funds.

Otávio de Magalhães Coutinho Vieira

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Coutinho Vieira**

I would like to complement Mr. Fernando's view. I believe that Brazil could come out of this crisis stronger than before in terms of the global perspective. Our debt to GDP ratio is decreasing, it now stands at approximately 38% and we will have growth of about 2% in 2009 which puts us in a very different position from countries like Italy that has over 100% debt to GDP and it will grow zero next year, or even negative.

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George Wachsmann

I would like to make a counterpoint to this point of view, which is more of a question than an answer. I agree that fundamentals in Brazil are better than the better than in the rest of the countries and we are entering this crisis not as the ones to blame, rather as the victims. But what I have been hearing and reading quite often is that this crisis is not about fundamentals. No one is looking at fundamentals but rather at the fact that liquidity, and therefore confidence, are also gone.

What I have been hearing and reading quite often is that this crisis is not about fundamentals. No one is looking at fundamentals, but rather at the fact that liquidity, and therefore confidence are also gone.



The fact that Brazil is an emerging market will not guarantee that things will improve so quickly. What I mean is that yes, Brazil is one of the leading emerging countries, but in this situation, we need to compare emerging markets, as an alternative asset class, against the G3 or G7 or G10 countries. If, on the one hand the opportunities in Brazil are great, you must also keep in mind that the opportunities in G3 or G7 countries are also huge. If you say that Brazilian companies are trading at bargains, some very well established companies in G7 countries are also trading at similar levels...

George Wachsmann

Depending on how the development of the current crisis will be, it will not suffice to have good fundamentals. Also, if we look down the road at a further rebound, the fact that Brazil is an emerging market will not guarantee that things will improve so quickly. What I mean is that yes, Brazil is one of the leading emerging countries, but in this situation, we need to compare emerging markets, as an alternative asset class, against the G3 or G7 or G10 countries. If, on the one hand the opportunities in Brazil are great, you must also keep in mind that the opportunities in G3 or G7 countries are also huge. If you say that Brazilian companies are trading at bargains, some very well established companies in G7 countries they are also trading at similar levels...

The question we should bear in mind is why should an investor, who is not a dedicated emerging market investor, invest in our Brazilian opportunities if he can have the same potential with potentially safer opportunities in the G3 or G7 markets? And even if you look at the emerging markets fundamentals, some people say that "Brazil is good, but China is the best". So, even within the emerging market context, there are other players, like Russia and its oil story etc. So, for Brazil, good fundamentals may not be enough... (as I said, they won't do the gimmick...)

Mauricio Levi

My view is a little bit different. We are cautiously optimistic. Contrary to most of the companies in the so-called developed world, Brazilian companies are not leveraged. In addition, I think that you cannot analyze the country by the stock market, which currently has only 450 companies listed.

Brazil is much larger than the stock market...Because of the inflationary problems and all the economic crisis the country suffered in the last 20 years, the average Brazilian entrepreneur or company owner is not used to leverage. The balance sheets of most of the companies are very sound. Adding to that, the situation of the country is much better now after having dealt with the

current account problem - Brazil now has enough foreign reserves to pay down all the public foreign debt. This is the first time in Brazil's history that the country is in such a condition.

The economy in Brazil can now be steered looking essentially at what happens in Brazil, and not at what happens abroad. Today, the Central Bank can maneuver the interest rates targeting to help the Brazilian economy to grow, even though we have a crisis outside! This was impossible in the earlier years or during previous crisis, because we had to attract capital to close the current account deficit.

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The economy in Brazil can now be steered looking essentially at what happens in Brazil, and not at what happens abroad. Today, the Central Bank can maneuver the interest rates targeting to help the Brazilian economy to grow, even though we have a crisis outside!

Brazil can remain at a path of sustainable growth of +3.5-4.0% over the next two to three years, and I think this is what's going to attract the capital.

Like in the last crisis in 1998, China was the only country which had sound fundamentals and they could maneuver their monetary policy to keep the country growing, despite the fact that all of the economies in the region were going down by -10% or -15% in GDP. I think this time Brazil has exactly the same characteristics.

Mauricio Levi



We believe that the so called developed world, the United States and Europe, are going to be lagging, with growth close to zero for the next year-and-a-half or two. Brazil can remain at a path of sustainable growth of +3.5-4.0% over the next two to three years, and I think this is what's going to attract the capital.

Like in the last crisis in 1998, China was the only country which had sound fundamentals and they could maneuver their monetary policy to keep the country growing, despite the fact that all of the economies in the region were going down by -10% or -15% in GDP. I think this time Brazil has exactly the same characteristics and this is why we are cautiously optimistic about the situation here in Brazil.

Walter Maciel

We are optimistic for Brazil in the long run. But in the short-term, due to the bursting of one of the largest bubbles ever created, money is flying back to safety. This means for Brazil that we suffer a tremendous lack of liquidity, as in many other EMs.

The headlines is the appreciation of the USD against the Euro, but you also see the Euro and the dollar going up against all emerging country's currencies. On the company level, we are having this stressful situation where firms are caught by credit contraction at the time when they were increasing capital expenditures and investments.

We also forecast that the Central Bank is going to have lots of trouble to stabilize the currency for the next few months. They are going to have to intervene with much greater reserves than they've

done so far. We think that the cycle of increasing rates will be halted, but in the short-term there is a dicotomy. Not only the liquidity trap, but reducing interest rates with the spreads of sovereign is going to be a challenge.

We believe that in the short-term, markets will still remain very volatile. There are still reasons to expect good performance in the next few months. Within interest rates, there are tremendous opportunities there especially in the short end of the curve. There are companies that have no debt and built up very good cash positions, and on the short side, firms which are indebted or need cash. We like companies with low multiples versus firms that really rely on growth.

Antonio Martins

Brazil is undoubtedly better prepared to face the crisis than any time in recent past. The economic fundamentals have improved, and the main difference is that today Brazilian government is a net creditor in USD. This means that when the Real devaluates, the debt to GDP ratio decreases rather than increases as we all saw during the past crisis. It's a huge transformation which allows Brazil to better absorb the international shocks by selling USD linked instruments and by not having to hike short term interest rates to attract capital. The risk lies on how the Brazilian government will face the global slowdown; it's time to shrink local demand so that we don't import the crisis through the balance of payments.

The world after the crisis will be a world without leverage and low global interest rates. In this kind of environment, emerging markets will be an alternative for global asset allocation: you don't need leverage and can earn very juicy returns in local bonds. And Brazil is certainly well positioned to capture the flow when it returns.

Sergio Goldman

In any crisis you have opportunities and risks, and I believe that this crisis, right now after the recent corrections, gives investors many more opportunities than risks. The second comment I would like to make that is that investors seem to be very skeptical on the concept of long-term investing. I think that the skepticism on this concept has reached its peak. However, there is a lot of value and many opportunities to be pursued for the medium to long-term term.

Patrick de Picciotto

I agree with Sergio's comments that obviously every crisis offers tremendous opportunities, and I think it's very hard for any of us to predict when this crisis will end and whether the crisis is happening because of fundamental reasons or, as George said, more due to sentiment and liquidity reasons (likely both!). Regardless of our overall conclusion, I think only those investors and investment firms who have a lot of staying power will be able to exploit the opportunities that have being created.

A big shake-up in the investment industry is very likely to happen, both in Brazil and around the world. Some of the firms which were formed over the past few months or few years will not be able to make it. They will become too small to attract the best talent and reward them for staying in business for one, two, or three years, which is likely the required time it will take to fully exploit the opportunities available now.

For those who have staying power, there will be significant less competition over the coming years and Brazil will offer tremendous opportunities, which we plan to capture on the equity side through our equity fund, M Square Brazil Value Fund, and beyond that, as Walter mentioned, in fixed income, currencies and other opportunities through our Latin America fund-of-funds, M Square Latin America. Outside of Brazil, many opportunities have also been created (such as credit), and we believe hedge funds will be one of the best vehicles to exploit them.

Otávio de Magalhães Coutinho Vieira

Let me address George's comments with a couple of indicators. He said that there are many bargains in the G7 countries and there are many bargains in the emerging market countries. But just remember that PE for 2009 in Brazil is below 8 and the PE for the G7 countries 2009 is above 10. Earnings growth in Brazil will be much better than earnings growth in the G7 countries. We have the highest real interest rates in the world and a lot of companies that are low-cost producers in terms of commodities and other goods. I believe that Brazil has certainly advantages that can attract the global capital.

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Otávio de Magalhães Coutinho Vieira



Luiz Felipe Pinheiro de Andrade

I believe that the fact that Brazil has good fundamentals has a positive effect. Currently you can say that the fundamentals are not important to pricing, but it will provide a floor from where prices will certainly rebound well. I also believe that in next years for Brazil will do much better than for other countries, Brazil has the potential for a sizable outperformance.

I think that US probably will still suffer next year, which will also affect us to some extent but a growth in 2009 between 2,5% and 3%, as it seems to be the case, is still a very good number by any standard.

The fact that Brazil has good fundamentals has a positive effect. While currently you can say that the fundamentals are not important to pricing, but it will provide a floor from where prices will certainly rebound well. I also believe that in next years for Brazil will do much better than for other countries, Brazil has the potential for a sizable outperformance.

Brazil is getting ahead of the pack compared to our emerging market peers. Besides all the macroeconomic outlook, every year that passes by, the country is becoming a different animal compared to other emerging markets in other dimensions which are also fundamental for investments. The institutional and legal framework is much stronger than it used to be, the political stability is a reality, and so on... Just as an example, if you take a look at the questionnaire that CAPERS uses to evaluate the conditions for investing in emerging markets, Brazil is clearly ahead of any other BRIC country.

Luiz Felipe Pinheiro de Andrade



In my view, Brazil is getting ahead of the pack compared to our emerging market peers. Besides all of the macroeconomic outlook, every year that passes by, the country is becoming a different animal compared to other emerging markets in other dimensions which are also fundamental for investments. The institutional and legal framework is much stronger than it used to be, the political stability is a reality, and so on... Just as an example, if you take a look at the questionnaire that CAPERS uses to evaluate the conditions for investing in emerging markets, Brazil is clearly ahead of any other BRIC country. There are several indications that Brazil is becoming a good investment destination, and the Brazilian economy will continue to attract foreign direct investments.

Patrick de Picciotto

A lot of our recent visitors from overseas have been endowments and foundations who are looking for dedicated equity opportunities in Brazil. Until recently, these investors were always mentioning opportunities in other BRICs as well, but, interestingly enough, lately some of these seasoned investors, said that the BRICs really became a 'B' to them. Here is why:

In China due to the lack of transparency and very unique regulatory issues, many of these institutions cannot invest. India, apparently has some serious issues...I am not an Indian expert, so I am not sure how real those issues are, but apparently India has very serious inflation problems and an election coming up next year, which typically freezes the country for a good period of time. Russia was hit by the commodity collapse, but there are also regulatory question marks and there is

much less confidence in the system by the locals, which can also leave the country outside of the investment universe of some institutions.



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Patrick de Picciotto

The current de-leveraging process will still take time, but looking forward Brazil will come out of this crisis maybe not in a better absolute position than today, but certainly in a better comparative position against the other countries I have mentioned.

Luiz Fernando Figueiredo

As it is now commonly known, Brazil improved a lot its macro fundamentals, external debt, debt to GDP ratio, inflation, industrial output, and so forth.

So on that side, you can compare Brazil with any other competitor in this market. But if you study the actual framework, the laws and regulations we have in Brazil, you will find that Brazil is far different from the others, and in this case in a very positive way.

For example, let's take a look at the banks or the financial system in Brazil. The regulations in place are very restrictive. Compared the the U.S. or Europe, I would say that our banks here can do only about 1% of what the banks in these other countries are allowed to do. Everything you own or owe must be consolidated on your balance sheet or outside your balance sheet. The capacity to leverage is much more limited. Our system was developed as a response to all of the crises we have had before, and now in this stressed environment it can actually offer protection.

So our situation is completely different than in other countries. Our financial system is really wealthy because it is well capitalized as a consequence of exactly these regulations which define the required capital levels.

You find a second differentiator when you look at the roots of the hedge fund industry from country to country. In the U.S. or Europe, the hedge funds came out of the corporate sector, many as start-ups, whereas in the case of Brazil, our hedge industry was really started by the mutual

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So our situation is completely different than in other countries. Our financial system is really wealthy, because it is well capitalized.

In the U.S. or Europe, the hedge funds came out of the corporate sector, many as start-ups, whereas in the case of Brazil, our hedge industry was really started by the mutual funds industry. What does this mean now? It means that the local hedge funds have started as a very transparent and regulated industry. For example, our NAV is published on a daily basis.

Luiz Fernando Figueiredo



funds industry. What does this mean now? It means that the local hedge funds have started as a very transparent and regulated industry. For example, our NAV is published on a daily basis, which is much different compared to many other countries, even G7 countries. This developed framework together with the positive macro fundamentals make Brazil really attractive.

Walter Maciel

I would like to clarify here that in our case, we are not pessimistic regarding the fund industry as there are going to be enormous opportunities. But we disagree a little bit on the outlook for the Brazilian economy, especially in the short-term.

We disagree a little bit on the outlook for the Brazilian economy, especially in the short-term.

I would like to highlight again that what we really see here in Brazil is the classic liquidity trap where money is going back and forth between banks. The money is not flowing to companies or to individuals, which makes us very, very worried about the financing conditions for companies. As we've said, generally Brazilian companies are un-leveraged, but we see big companies whose bold investment plans are now hit by surprise with this crisis. The situation is an enormous reversal compared to the perspectives we had for Brazil just three or four months ago.

Walter Maciel



I would like to highlight again that what we really see here in Brazil is the classic liquidity trap where money is going back and forth between banks. These monies are not flowing to companies or to individuals, which makes us very, very worried about the financing conditions for companies. As we've said, generally Brazilian companies are un-leveraged, but we see big companies whose bold investment plans are now hit by surprise with this crisis. The situation is an enormous reversal compared to the perspectives we had for Brazil just three or four months ago.

What we are really seeing is that banks are paying staggering rates for CD deposits which leaves us worried about the contraction in credit and the consequences for the economy in the next few months.

George Wachsmann

That's correct, here we have the problem with CDs and the high rates. The banks have gathered a lot of money and, for the first time, they are able to lock this money for one, two, or three years. Sure, the money will come back and chase returns when the situation changes, but for now, the situation is tough.

Having said that, there are also some positive aspects coming from the banking sector consolidation. One factor is that lots of good people lose their jobs, and some of them will be starting independent shops. Those starting new hedge funds will also benefit from the opportunities

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Having said that, there are also some positive aspects coming from the banking sector consolidation. One factor is that lots of good people lose their jobs, and some of them will be starting independent shops. Those starting new hedge funds will also benefit from the opportunities that will arise in the wake of the current crisis - and this is another nice 'push'. And the third factor is the flow of new money looking after opportunities. While the cash is not here now, it is trapped and should be available again soon!

George Wachsmann

that will arise in the wake of the current crisis - and this is another nice 'push'. And the third factor is the flow of new money looking after opportunities. While the cash is not here now, it is trapped and should be available again soon!

Even though we are seeing many companies closing shop, most probably we are about to see great opportunities everywhere we look, be it locally or globally. While we are now seeing a diminishing number of companies or investment managers, it is also highly probable that the number of hedge funds will go up again, in the near future.

Some people even say that we will see a "Mother of all recoveries". So, even if some of the money is locked in at the bank level, remember that hedge funds themselves never had so much cash put aside. There should be a lot of money available after the de-leveraging wave - both from the consolidation process and the new shops.

Mauricio Levi

One comment regarding this "mother of all recoveries" story. For the 15 years that we have been managing equities, especially from 1993 to 2002, we had almost one crisis every two years. All of them were the mother of all crises and following on we always had the mother of all recoveries. So each current crisis has always been the most severe crisis - it is always the crisis now, and not the one which we are going to see in the future years.

I think that what is important is to look at the quality of the invested capital. We have had a huge flow of money coming from abroad, mainly from investors that didn't know where they were investing their money. You had IPOs last year which were bought on average 75-85% by foreigners. Most of them had no idea what the companies did, and those who buy something they don't know what it is, they sell it at the same pace.

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This hot money which came into the country is not the kind of money that you want to have in your investments. The same thing happened to the fund industry, where many investors just bought historical track records instead of trying to understand what they were buying into. So the same money that comes in, is then the money that goes out.

Mauricio Levi



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Obviously, we now have a deflation of assets in the world due to the de-leveraging, or because of the hot money going out, or people get afraid or they start seeing the dark side, or the bad side of the story, whereas in the past they were only looking at the good or shiny side of the story. However, there is still money being set aside to come to Brazil, especially from long-term investors.

The investment grade status that Brazil reached now attracts capital from institutional investors, who before could not even look at Brazil. The size of the assets allocated to Asia is still huge while Brazil or Latin America is still irrelevant in these portfolios. But this kind of money will start flowing to the country, it is a new class of money which is coming in.

Recovery is a matter of time, the markets have to get over this panic. The volatility is enormous - markets going up 5-10% one day which means they are coming down the same amount the next day, that is not sustainable. Once the panic is over, the fundamentals will come back into place, and subsequently the capital will come. This is the sequence, and it is going to take some time. But again, as all the other mother of crisis that we have had, we are going to have another mother of all recoveries.

Luiz Fernando Figueiredo

Comparing the current crisis with the past ones, I don't think Brazil will suffer such a big trauma as we had in 2002. At that time, nobody was trusting even in our public debt. The situation now is completely different.

To be frank, I don't think that investors in Multimercado Funds, the onshore Brazilian hedge funds, which may be down -5 or -10% in a year, are now walking away and say they will never enter this kind of investment anymore. Also having invested in equities, where a stock may be down -30%, many investors will decide to hold on to it because they think this is only a momentary undervaluation, and the correction towards the upside will be coming.

Taking into account the positive fundamentals of Brazil, especially the sound financial system, I also see the investors coming back step-by-step. What is now uncertainty will then be perceived as opportunity...

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Walter Maciel

Analyzing the crisis, I would like to point out that here and also in the developed markets we are not really dealing with distressed assets, but very, very good assets which are on fire sale by distressed sellers. This is providing interesting opportunities and basically the reason why money is going back to the U.S. from major EMs. I think we will keep seeing these kind of flows in the short-term.

Mid-term, there will be more opportunities in countries going through a soft landing as Brazil, rather than countries going through recession or depression in the years to come. As I said, not very optimistic in the short-term, but we are quite optimistic in the long run.

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Mid-term, there will be more opportunities in countries going through a soft landing as Brazil, rather than countries going through recession or depression in the years to come.

Walter Maciel



Regarding the fund industry, it's interesting that firms like Goldman Sachs and Morgan Stanley are adopting the Basel rules, so that the kind of leverage they used to play with is gone - it's over, and we are not going to see that again. Therefore, hedge funds will more and more be the vehicle for investors who seek risk high returns and leverage.

**Luiz Felipe Pinheiro
de Andrade**

I would like to add a comment regarding the liquidity trap which we are discussing here. Yes there is a shortage of liquidity right now. We are in an acute phase especially in the domestic corporate market, where banks are holding tight because the banks are checking out potentially harmful situations with derivatives positions that some companies have gotten into, particularly some large companies.

But the retail lending is still completely open. No bank has reduced the credit lines and the amount of money available for retail investors. To the contrary, we may even see a growth in retail lending. It won't be like a 30% growth, but banks talk about 10-15% growth on the retail side.

By the end of the year we will probably see liquidity coming to the market. Our domestic banks are liquid, never before they had so much cash. It is unsustainable, at some point they cannot support this level of cash they are holding.

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Let me also add that in some cases our domestic hedge funds are, on the retail side, also surfing for a typical investor who ends up buying the wrong product.

With local hedge fund investors, the problem is that we - as an industry - sold them hedge funds while they thought are getting cash enhancement products.

I also want to add that in this crisis, there wasn't actually a lot of destruction of wealth in Brazil, because the average exposure for equities in Brazil is minimum.

Luiz Felipe Pinheiro de Andrade



Some people say the credit spreads are high or too high, but maybe they are normal now - remember that credit spreads in Brazil used to be zero or ridiculously low. I think now we have more reasonable credit spreads.

I agree with Mauricio that Brazil had a problem with the wrong investors and the wrong products. Foreign investors were in general "hot money", and I also think that with endowments and foundations coming in now, we will have a more long-term oriented investor base, which will change market conditions.

Let me also add that in some cases our domestic hedge funds are, on the retail side, also surfing for a typical investor who ends up buying the wrong product. In our firm, we offer retail funds and hedge funds for private clients.

Interestingly, we are not having redemptions on the equity products. The retail investors in the equity products are not redeeming, but the private clients who may be losing 5% - because the

average fund-of-funds is running at 50% of the CDI - are running like crazy from the product, while investors who lost 40% are not worried. They stay in the game. With local hedge fund investors, the problem is that we - as an industry - sold them hedge funds while they were getting cash enhancement products.

I assume we will be seeing money coming back into these products, maybe at lesser volumes, but the right buyers will come: investors who search exposure to and the expertise of hedge funds, and not those that are replacing DI funds or a CD with a hedge fund. They were buying wrongly, the advice they got was terrible.

I also want to add that in this crisis, there wasn't actually a lot of destruction of wealth in Brazil, because the average exposure for equities in Brazil is minimum.

Antonio Martins

I totally agree with Luiz Felipe and Mauricio in the sense that a lot of people bought hedge funds without knowing what they were buying. Local hedge funds were sold as enhanced cash. People were told that hedge funds could make money in each and every 12 month period. That is simple not true.

Last year in Brazil we saw a huge liquidity creation with the IPOs and M&A activity, and a good chunk of that money went to hedge funds. The risk appetite was low and the forward interest rates were appointing for one digit annual yields which is a very low rate for Brazilian standards. The industry had a lot of money to put to work. And they did it through selling wrong products for wrong people. When the hedge funds experienced a drawdown, which is a positive return but lower than the CDI, the wrong people rushed to the doors creating panic selling and bad newspaper news.

The hedge fund industry grew a lot in the last two years, both in number of funds, new strategies, longer redemption rules, and were even allowed the possibility to invest in offshore markets. Now, with all the redemptions and market turmoil, the industry will walk one or two steps back and even considering this, the five year results are still very positive.

George Wachsmann

When talking to my clients, I hear that hedge funds were seen as the solution for an optimized portfolio. They believe, or they were told that now they don't need to think about cash and equities, a hedge fund manager will take care of that for them in a much better fashion than an equity player, as he is able to short, etcetera. I ask myself: given the opportunities in equities, given the performance of hedge funds, given the high interest rates - is it still the best advice to go with hedge funds as an alternate asset class?

In Brazil, during the years when the stock market did great, it was better to have cash and equities, and when the markets did poor, you were better off in bonds and cash. Of course, you must have the right timing, but it also seems that by going back to basics, so to speak, the opportunities in the upside are greater, particularly greater than the risks coming from the downside.

Luiz Felipe Pinheiro de Andrade

On this fundamental question, I think you'll never have the right answer...but you are right, if you do a backtest, a 80:20 allocation has always been a fantastic investment in Brazil, since the

Equities should be part of the portfolio, but also alternative investments like private equity, hedge funds and other asset classes should always be part of any portfolio. What should not happen is to put your cash, your conservative piece into hedge funds, because then you have a problem.

Just like medicine, if you use it wisely, it will fight the disease, but if you take it wrongly, you may get a lot of side effects. So what we are witnessing currently seems like a hangover from hedge funds...who can really complain to have invested in a class that has delivered +7% nominal return in Brazil, like our local hedge funds, when equities are down -50%?

Luiz Felipe Pinheiro de Andrade



volatility creates a convexity on your portfolio, which really delivers a lot of returns.

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Getting +5 or +7% returns in the worst year of the hedge fund industry, when equities are halved, you should be happy with the returns.

Mauricio Levi

Yes this is becoming a point of discussion now, investing in hedge funds against going back to the long-only's and fixed income. The hedge fund world has changed, or the way the hedge funds are seen has changed, because most hedge funds were sold as absolute return vehicles, and absolute returns have proven to not be feasible.

Hedge funds may be a different category of funds, they may have less risk or a different kind of return, a different return profile, a different volatility or a different alpha source, but they cannot be sold or they cannot be offered as absolute return, as this crisis has shown.

Next is that in any portfolio should be constructed on the risks an investor wants to take, that will determine the allocation to equities, fixed income and so on.

While we all know that equities over time tend to outperform any other strategy, there are obviously risks involved investing in equities. Curiously enough, market timing seems to be a major trap for many investors. We had the access to statistics of a hedge fund in the United States which has returned about +15%, per year for the last 20 years, but when they calculated the average returns of their investors, it turned out to be only +5% per year; because investors usually buy and exit at the wrong time.

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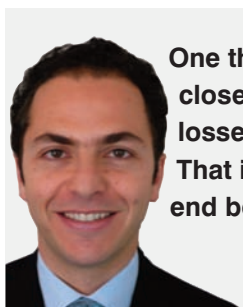


Despite having a very long track record of +15% annual returns, his investors never got the 15% because they are never fully invested. If you are out of the markets and you lose one or two of the ten most important rallies of the market, your average returns go down significantly.

We have not mentioned it clearly yet, but you have to separate hedge funds abroad - those in the States, Europe or Asia - and hedge funds in Brazil. I think those are two completely distinct discussions.

In Brazil, we have a unique case where the industry is almost entirely referenced to a benchmark, the CDI, which makes the opportunity cost much bigger than abroad. As managers of a global fund-of-funds, I tend to somewhat agree with Mauricio on the change of investors' perceptions regarding hedge funds. But I would still maintain that hedge funds have fulfilled their mandate, at least the good ones. As an example, since this whole crisis started, which in our opinion was in July/ August of 2007 until the beginning of September 2008, equity indices in the U.S. and in Europe were already sharply down, while hedge funds in general were flat.

September was the one data point which was an exception and needs particular consideration. Not only because there were severe losses in equities - banks going out of business etc. - but more so due to the many sudden changes in regulation. The ban in short sales, directly affects the hedge fund business model. So I believe this month has to be analyzed with caution, because long-short hedge funds all of a sudden could not do 50% of what they typically do. I believe one cannot really judge a manager only by its September performance.



One thing that will happen regardless of the result of this crisis is that people will have to get closer to their hedge fund managers. need to know them and their portfolios better. Many fund losses are permanent because they resulted from leverage or from trades that have been exited. That is very different than mark to market losses, (which might be even exacerbated until year-end because of redemptions) which could still be recovered if you can stay with the position.

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In terms of timing, hedge fund investing is even more difficult than in equities. It is very difficult to know when to enter and exit a fund, especially because of the fund's liquidity terms. If you invest now and disinvest at the end of the year and then reinvest again, it is very unlikely that your returns are going to be optimal. Also as a consequence of this "inability to exit freely", more and more people will need to know much better what they own.

As fund-of-funds managers, we already are very close to our managers. The last thing someone like us wants are surprises...when you are invested in the simpler strategies like credit long-short, equity long-short, with very little or no leverage, no counter-party risks etc., you reduce the chances of negative surprises. In those strategies, even if you might be down now, you know that this loss could eventually be recovered.

If you are invested in funds with highly complex structures that depend on leverage in order to deliver returns, like fixed income arbitrage for example, then you may have a problem. M Square has never liked leverage in general so our exposure to this kind of fund is minimal.

For the next couple of years, the investment theme will be "back to the basics". Fundamental analysis both on credit and on equity. Going long good stocks and good credits and short bad stocks and bad credit will be what could make a lot of money over the next three or so.

I also believe that investors in general are entitled to, and should ask for more disclosure than they have been getting. But I don't think that can entirely be blamed on the managers. As we mentioned before, a lot of people bought funds - hedge funds, equity funds or other funds - without having

any idea of what they bought, so the responsibility lies on both sides.

Walter Maciel

The discussion about different products is very, very subjective. We run long/only, long/short, and macro products, we like all of them, their different profiles suit different investors with different profiles. The challenge for an asset manager is in the end to generate Alpha and protect the investors in times of crisis like this.

In equities, long/short or macro, you have to search for Beta when there is opportunity but as soon as a bear market comes, you need the ability to hedge your products decently. That is how you create asymmetry for the investor and an attractive long-term track record. So far in Brazil, the average industry is performing quite well.

A long-only fund in Brazil has to remain 67% long at least, as per legislation and in the case of our own long-only fund, in 2006 we returned about +70% against 40% in the Bovespa. In 2007 it was +72% against +42% in the Bovespa, and this year we are down -28% where the Bovespa is down almost -40%. An average 45% Alpha since inception.

I would say this is the kind of performance the investor is searching for given the situation that the fund that has to stay at least 67% long. With a minimum 67% long, it is quite impossible to produce a positive return in a year like 2008. With Macro or multi-strategy funds the challenge is almost the same, not necessarily you have beat the local benchmark this year, but you have to protect the investors and preserve your track-record.

Luiz Fernando Figueiredo

I want to share an interesting observation. At Mauá, one of our funds, just one macro strategy, had a poor performance in the first quarter of the year, it was a kind of outlier during this period. But what happened was that after this quarter, there were a lot of redemptions even in funds that were performing well. And the amount of the redemption that both had were basically the same. I assume that other asset managers in a similar situation would experience the same... Our macro fund Mauá FIM is about -6% down YTD, and Mauá Top, another macro fund, but completely opportunistic, is like or maybe 1% below the CDI during this year.

As we know, the last six months were very tough for the industry. But in each month, Mauá Top was positive when compared with the CDI. We have had the redemptions before, in the first quarter, as I said, but even in this situation, which such good returns, the inflows in the fund were rather negligible. I would like to think that our industry is in a very early stage and that we must continue to educate our investors, especially if you run multiple funds in multiple strategies, what the differences are between the funds that are managed by the same firm.

Antonio Martins

The financial landscape will change, and so will the hedge fund industry. The de-leveraging that is occurring in Europe, United States, Brazil etc. has created enormous opportunities. I think, everyone here agrees with that.

The hedge fund industry has mutated from a sellers' market into a buyers' market. The hedge fund industry here in Brazil and abroad will be a buyers' market, an investors' market. It will be the investors, who have the money and the power. It wasn't like that a few years ago. In every buyers' market, the price you charge for your product is the first thing to be adjusted downwards. So possibly some hedge fund managers will have to lower the fees to attract capital and/or to give up some of the upside in the equity of the management company in the process...



Antonio Martins

I don't agree with some of the criticism that you can hear at times, that the hedge fund industry is dead, that the managers all have become dumb etc, I don't think so. In order to address hedge fund performance, I think it's not fair to extrapolate the last twelve month returns, as they are very poor; as it was not fair to extrapolate the last twelve month returns ended in June 2007, when the

returns were inflated by the booming markets. If you look at what happened in Brazil in 2002, we had an enormous crisis, a fundamental crisis of confidence, but the hedge fund industry here performed very well in 2002.

Looking forward, I think the hedge fund industry has mutated from a sellers' market into a buyers' market. The hedge fund industry here in Brazil and abroad will be a buyers' market, an investors' market. It will be the investors, who have the money and the power. It wasn't like that a few years ago. The industry will also work towards more transparency. Even on the corporate side of the asset management firms, changes may happen. In every buyers' market, the price you charge for your product is the first thing to be adjusted downwards. So possibly some hedge fund managers will have to lower the fees to attract capital and/or to give up some of the upside in the equity of the management company in the process...

George Wachsmann

I was asked to give answers to the questions I had posed before this Roundtable previously; so let me throw this in... On the macro perspective, I agree that Brazil is a better opportunity.

We have been increasing the Brazil exposure to most of our clients, to those that have that capacity. We have been doing this throughout the year, and especially in the last few weeks.

On the question on cash and equities, the 80-20 discussion against hedge funds, we have been dramatically increasing our cash positions since the end of 2007, up to 80-90% in some of our clients. But now, we started to increase our allocation in equities. Therefore, in comparison, we have more equities now than we had last year, and the funding is coming from hedge fund investments.

We did not have offshore equities before, and now we have – not that much, anyway. When we look at local hedge funds, we treat each strategy very differently. Market neutral has one treatment; long/short has another; quant is something different, etc. We even split up the macro strategy, since funds are so different one another. Each macro fund is different. In my view, cash and equities are a good substitution for some strategies, but certainly not for all of them.

I agree that we have entered a buyers' market mode, but there are still some conundrums left to be answered. For example, if managers want more money now, they should be willing to reduce their price, that is, to reduce fees or offer better terms.

On the other hand, as we see everywhere now, here, in the US and offshore, liquidity terms were too loose. In Brazil, the few problems we have are due to having wrong liquidity terms, in equity funds. Offshore, every fund is under pressure. Most of the funds are using a 'gate' mechanism, if they have one. They are closing their funds for redemption – something weird according to the Brazilian regulatory context – but quite common today in the international circuit. So, while on the one hand you want to be more flexible, on the other you should be tightening liquidity terms. I don't have a good answer for that, it's a conundrum, as I said.

At this moment, it also seems that the entire world will be going after hedge funds, and impose more legislation. That will probably affect returns, to some extent.

The notion that hedge funds as alpha machines has been disproved, they are not.

Going forward, asset allocators and investors will definitely have to dedicate more time to asset class analysis and manager selection in order to generate excess returns. They will invest more in ETFs, in equity long-only funds, in simple strategies plus some very few alpha strategies such as private equity.

Otávio de Magalhães Coutinho Vieira



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So I think that the investment world, the asset allocation and the allocation process will be different. It will come at the cost of the hedge fund industry, which may be shrinking in the process.

Patrick de Picciotto

A year ago, most of the best talented managers in the world were closed, one could not invest in them. Currently, with very few exceptions, this has changed. Most hedge fund managers are open so, in that sense, yes it's a buyers' market.

However, I don't believe that hedge fund managers, the really talented ones, will lower their fees. Not unless it's not in exchange of something. And that something is certainly liquidity (longer term lock ups and redemption terms). In our long-biased Brazilian equities offshore fund, we charge 2% and 20%. But for investors with annual liquidity (as opposed to quarterly) the fees charged are a bit lower, 1.5% and 15%. Managers might also offer more favorable terms to investors who agree to anniversary lockups, as opposed to a specific redemption dates, for example.

I believe that many managers will be willing to trade some fees for improved liquidity, from the manager's perspective (i.e. money invested with longer redemption/lock-up periods). Think about it, doing so aligns investors more with the manager, who are able to exploit the opportunities better and then, at the end of the day, both your investors and the fund itself are going to make more money. In summary, I believe the power of investors to ask for reduced fees will only be achieved in exchange of more aligned investments. I won't even call it worse, but more aligned terms.

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Going forward, I sense that more people are willing to invest the equity part of their portfolio in dedicated funds or even stocks rather than doing that through multi-strategy funds etc. Thus, equity related strategies (mainly long-only and long-biased funds) might receive money before the multi-strategy funds in general.

Patrick de Picciotto



The current period is showing how crucial it is to have a strong investor base. In that sense, the work we have been doing here at M Square is paying off. We have two distinct pools of investors, both of high quality and very complementary: Brazilian wealthy families and foreign dedicated equity investors, both largely long term LPs. Throughout this crisis, we have been able to attract investors for the Brazilian equity fund and have been able to keep redemptions on the fund of funds quite limited (<15%), so overall our assets are stable compared to six months ago.

Going forward, I sense that more people are willing to invest the equity part of their portfolio in dedicated funds or even stocks rather than doing that through multi-strategy funds etc. Thus, equity related strategies (mainly long-only and long-biased funds) might receive money before the

multi-strategy funds in general. This is something we hear from most of the allocators both in Brazil and abroad. At a later stage, money will go back into multi-strategy hedge funds. The managers who will be around then will be those with the most stable investor base, that have been able to preserve capital during this crisis and retained their top talent.

Going forward, we do see many of the global hedge funds generating very attractive returns especially on the credit/distressed market, where very specific skills are required and the dislocations have been huge. Equity-related strategies should also be attractive, given the valuation levels global markets are currently trading at.

One last comment I believe is pertinent is that hedge funds will continue to attract the most talented people and will likely continue to deliver the most attractive returns going forward on a risk adjusted basis. Comments that hedge funds are dead and that the current model is flawed are greatly exaggerated, in my opinion. The likely result of this turmoil will likely be an increased attention on transparency and alignment of investors and managers, as well as a concentration of inflows and resources on those managers that have been able to prove themselves throughout this crisis.

Mauricio Levi

This discussion about liquidity and fees is very dangerous because, obviously we are going to see some managers and especially the new ones opt for liquidity, which will be a huge mistake from the part of these managers. They are setting the trap for themselves going forward. We have seen this in the industry here to a limited extent and also outside of the country, many times over and over. Especially new managers, they want to raise capital quickly to pay for their set up and therefore raise any kind of money with very short-term liquidity, which will be the big trap which they get themselves into at some point in the future.

I would expect that responsible managers and the managers that survive this crisis will not exchange the terms and go for shorter liquidity. Maybe they would change the terms going longer. Managers which have reached already the capacity to raise capital with a yearly lockup or three or four redemptions a year, a responsible manager will never accept to go to monthly liquidity or bi-monthly liquidity in exchange for money; I would not expect someone to do that.

On the other hand, while this is a buyers market, it's the time for the good managers to enhance the quality of their investors and not have again the kind of assets that we saw coming in the last three to four years. We had seen investors who had money in time deposits coming to hedge funds or investing in equity, just because they read the in newspaper that equities were a good investment. We have had this here in Brazil, where you could come across some retired teachers trying to understand what is equity, or the guy at the party talking to you, "I have made so much

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Mauricio Levi



return on equities, now I don't need to work anymore," and now he has to go and find a job again. I think that's where the industry must pay attention to, to make sure this doesn't happen again. Let the good capital come, the bad capital doesn't have to come...

Luiz Felipe Andrade

At this Roundtable we used the expression "alpha machines" , I think that is the major point. We sold, or we claimed to sell "alpha making machines" - which was basically a fairytale. When I take on my academic hat, I don't believe in alpha. For me, it's always risk that you are taking, and maybe it is risk that is also not disclosed well.

The discussion of liquidity here is, kind of, an example of this. They are not talking about alpha, they are talking about selling liquidity. Selling liquidity has a price, and that is how we get extra alpha, because we do not price the liquidity and don't measure the risk...

So one problem with hedge funds is that some risks are not properly disclosed. This need to get long-term windows for redemptions etc. is due to the fact that a manager makes money selling liquidity, with all the risks that comes along with that.

If the market is illiquid, and a manager provides liquidity, he has to be rewarded for that. Investors need to know these kinds of risks, so that they do not buy the fairytale. They have to include the secondary risk on these strategies in their considerations. There is no alpha machine, like any other investment, there is a lot of risk, you can't say "I don't take risk and make money..."

So unfortunately, this is what happens. You get investors who are not knowledgeable about the kinds of risk they are taking. And if according to their view something unexpected happens, some people are quick to say "oh, this asset class is not good...". But the real problem is that they bought something without knowing what they are getting. You need lockups in hedge funds, because part of the game comes from being a liquidity provider.

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