

# HEDGE FUND INVESTING INTERNATIONALLY FOR BRAZILIAN INVESTORS

## RESEARCH, MANAGER SELECTION, AND PORTFOLIO CONSTRUCTION FOCUSED ON INVESTORS FROM BRAZIL

Risk Advisors Inc. assists Brazilian investors seeking to add international diversification to their portfolios. In close collaboration with the client, Risk Advisors draws on its research expertise and knowledge of the offshore alternative market to identify and evaluate international hedge funds that best address the client's return goals and risk parameters. An engagement is tailored to the needs and objectives of the client and will entail one or a combination of the following services: the selection of appropriate funds, construction of a portfolio of funds, periodic monitoring of the performance of investments, and periodic rebalancing of the portfolio, including allocation to new funds.

### RISK ADVISORS DELIVERS:

- » **Manager Selection** - Identify and select hedge fund managers through in-depth research
- » **Portfolio Construction** - Develop a portfolio of funds using quantitative and qualitative asset allocation tools
- » **Exploratory Study** - Introduction to niche strategies in the US, Europe, and key emerging markets
- » **Regulatory Environment** - Explain regulatory changes and their impact on the hedge fund industry
- » **Information and Reporting** - Regular reporting of qualitative information and quantitative metrics
- » **Investors from Brazil** - Focused on understanding and serving the needs of investors from Brazil

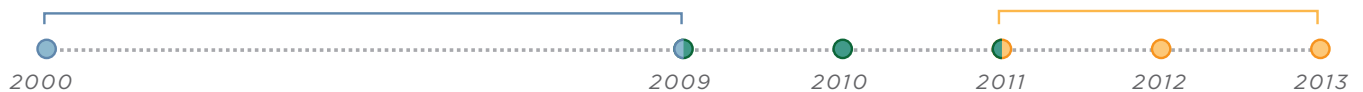
## HISTORICAL CONTEXT

### Pre-2008

- Brazilians investors invested with international hedge funds with activity picking up considerably after 2000 as a result of the country's growing prosperity
- Investors were largely High Net Worth individuals investing through private banks, single family offices, and multi-family offices
- Investors favored strategies commonly found at home such as Macro, Fixed Income, and to a lesser degree Long/Short Equity

### 2011-2013

- In 2011, the domestic economy began to slow and rising inflation resulted in deteriorating investment conditions
- The domestic equity market suffered a significant correction from which it has yet to recover
- Initially, high real interest rates kept investors focused on domestic fixed income options, but the deterioration of the Real in mid-2013 has dramatically altered their outlook



### 2008-2011

- The financial crisis of 2008 caused a dramatic change in the international investing environment
- Brazilian investor sentiment towards offshore hedge funds turned negative fueled by poor performance, gating, and the Madoff scandal
- In contrast, the investment environment in Brazil remained robust, marked by solid economic performance, a booming equity market, high real interest rates, and an appreciating Real

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## CURRENT ENVIRONMENT

Brazilians have again begun to explore the possibility of investing offshore. Given the outsized returns of the international equity markets (especially in the US), much of this initial interest has been focused on equity mutual funds. As these international market(s) return to historical norms of performance, we fully anticipate that the more sophisticated investors will once again look to hedge fund alternatives to provide consistently positive and less volatile returns.

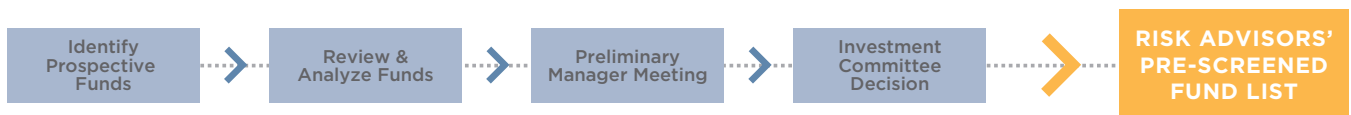
At the same time, it is very important to recognize that the landscape is different today than it was five years ago. Domestic economic growth, most notably that of the local financial industry, has generated significant wealth and broadened the investor base. In addition, today there are far fewer restrictions on offshore investing - greatly simplifying the task of local investors looking to diversify their holdings internationally.

The limited exposure to the international investment markets in recent years has led to a lag in knowledge of international hedge funds. While Brazilians have been focused on domestic investment opportunities, the landscape of offshore hedge funds has changed considerably. Many major hedge funds and funds of funds have closed or dissolved in the past five years. At the same time, Macro and Long/Short Equity strategies (the strategies favored by Brazilians historically) have not performed well, especially compared to the US equity indices. As is to be expected, the dramatically altered market conditions of the past five years have fostered not only a new generation of hedge fund managers but also new investment strategies and approaches that for the most part are unfamiliar to the Brazilian investors.

## THE ELEMENTS OF OUR APPROACH

### RESEARCH

Research is critical to remaining current with developments in the hedge fund industry, both in terms of investment strategies as well as management teams. Given the current environment, its importance is magnified yet further by the rapidly changing regulatory landscape.



The immediate objective of our hedge fund research process is to identify, analyze, monitor, track, and select funds to be added to Risk Advisors' pre-screened fund list. We initiate the research process by reviewing hedge fund trends and investment themes. We screen industry hedge fund databases and leverage existing relationships with managers and investors. Having identified prospective funds, we analyze fund offering documents, investor materials, and performance fact sheets. On comparing fund returns against relevant benchmarks, we focus on anomalies in an effort to measure consistency and to understand the outsized returns - positive as well as negative.

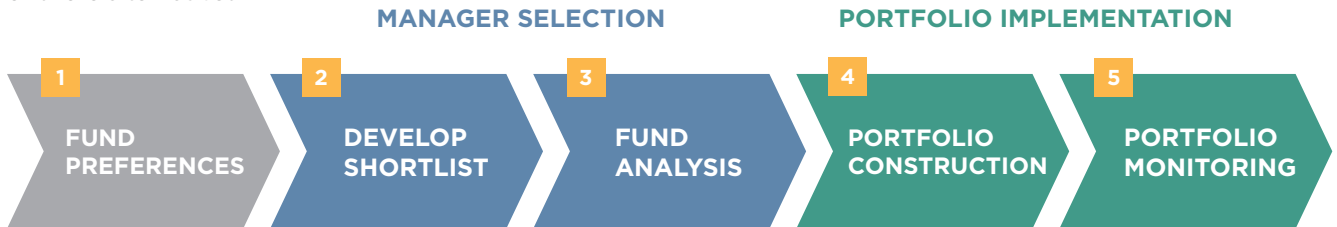
This initial filtering process is followed by a meeting with the portfolio management team of funds that we deem to be of interest. These in-person meetings are critical to enhance our understanding of the funds strategy and investment process. It is also an excellent opportunity to discuss with the management team any questions or concerns we may have. After the preliminary meeting, our investment committee reviews the merits and risks of a given fund and decides whether to approve its inclusion in our list of pre-screened funds.

For each of the approved funds, Risk Advisors develops a standardized fund brief that contains the manager's background, key service providers, and the performance history. The fund information and returns are added to the Risk Advisors' database. We track the performance of each pre-screened fund by periodically revisiting and updating the fund brief that we share with our clients upon request.

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## SERVICES

Risk Advisors seeks to engage with the Brazilian investor by providing services that are tailored to meet their needs. The goal is to create a synergistic relationship between our investment expertise and the client's objectives that will lead to successful investments in single funds or the construction and on-going management of a portfolio of offshore alternatives.



### ➤ 1. FUND PREFERENCES

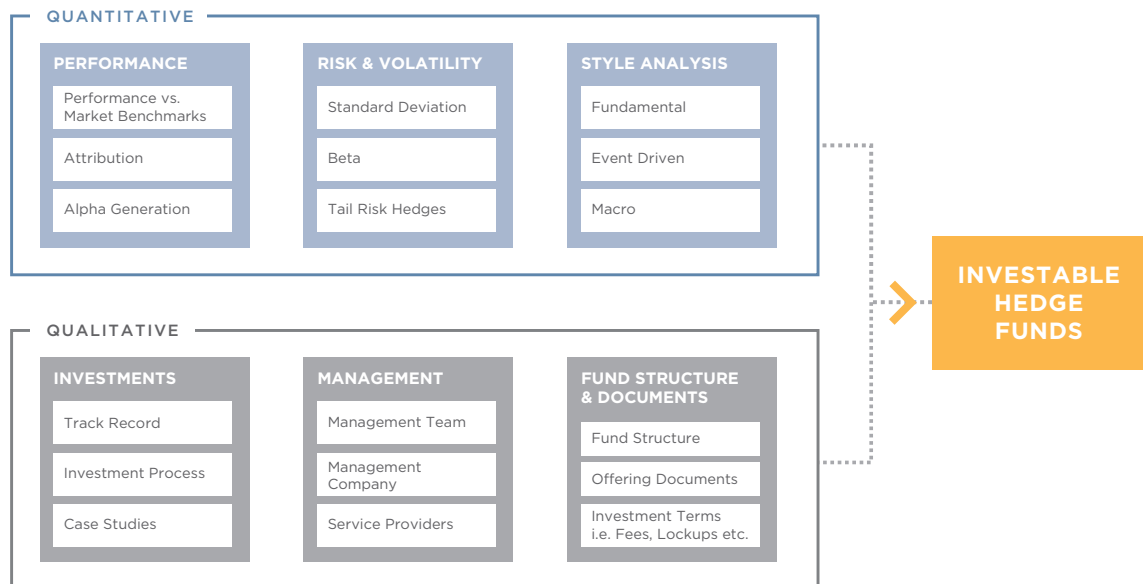
Continuous, open dialogue with the client is central to our approach. The first step in developing this relationship is to understand the client's investment objectives. An important element of this process is to determine the client's preferences vis a vis strategies and asset classes. Critical to this undertaking is to define the investment's qualitative and quantitative parameters. Risk Advisors will be focused primarily on the near term at this stage, while maintaining focus on the long range implications of any investment and the fact that a client can change priorities over time.

### ➤ 2. DEVELOP SHORTLIST

Once we have an understanding of our client's preferences, we will select funds from our pre-screened list of products that meet the criteria. Through our contacts in the industry and our continuous research, we will identify additional funds that fit the targeted investment profile. Through our ongoing dialogue with the client, further analysis and on-site visits with the managers, options are narrowed down to a shortlist of investment candidates. This narrowed universe will be the focus of the final stage in the investment selection process.

### ➤ 3. FUND ANALYSIS

Risk Advisors uses the developed shortlist to engage in an in-depth quantitative and qualitative analysis of each of the funds.



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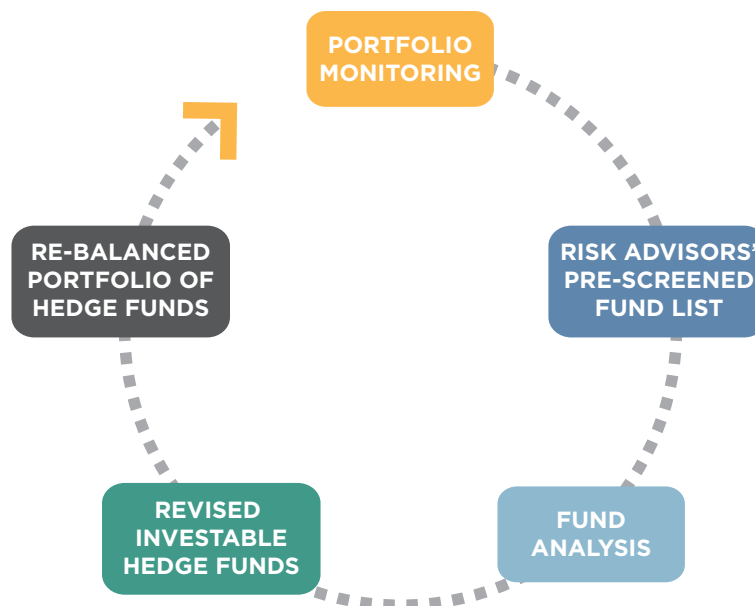
## 4. PORTFOLIO CONSTRUCTION

Typically, clients will be seeking individual funds to add to existing portfolios or will be interested in developing a portfolio of offshore hedge funds. In either scenario, it is critical to determine how a given investment will impact an investment portfolio. We employ Mean Variance portfolio optimization to allocate assets to one or more funds. We use this as a tool to allow our clients to maximize profit for different levels of risk. Our investment committee works closely with the client to finalize the recommended portfolio allocation. Before we implement the portfolio, our team will assist the client in negotiating investment terms with the managers. This phase would determine which share class to invest in as well as the definition of any special terms that might apply. On finalizing these conditions and terms, Risk Advisors coordinates the individual investments in the amount determined to be appropriate.



## 5. PORTFOLIO MONITORING

Once the final investment is made, Risk Advisors continues to monitor the performance of the fund(s). The monthly reported returns are used to perform monthly reviews that are forwarded to the client. Occasionally, on-site visits with the managers are undertaken to add a qualitative element to the quantitative oversight to the monthly reports. Risk Advisors produces ad hoc reports on funds as market conditions or events might warrant. We consider close, continuous contact with our clients a critical element in our process. This interactive relationship is central to both the monitoring of existing investments and identifying new investment vehicles that meet the objectives and risk/return parameters of our clients.



# HEDGE FUND INVESTING INTERNATIONALLY FOR BRAZILIAN INVESTORS

## **CASE STUDY:** *IDENTIFYING HEDGE FUND INVESTMENT OPPORTUNITIES FOR A BRAZILIAN FAMILY OFFICE*

Our client, a Brazilian Family Office, was seeking exposure to US markets and had planned to allocate USD 20 million in investable assets. The client had an initial idea of the types of investment strategies that they were interested in and approached Risk Advisors with a preliminary list of funds. The client was looking to construct a portfolio of diverse funds, rather than allocate all the investable assets in a single fund. Our mandate was to analyze the given list of funds as well as to identify and propose other funds that would match the investor's parameters. Risk Advisors met with the client to get a better understanding of their investment preferences and through discussion decided to focus on equity strategies and opportunistic credit strategies, with a preference for emerging managers based out of the US.

### **SOLUTION**

- Compiled a preliminary list of 12 funds to analyze, 5 funds came from a list of emerging managers provided by the Brazilian family office and 7 funds from Risk Advisors' pre-screened database and existing industry relationships.
- Analyzed the fund performances versus relative benchmarks and other similar funds in the industry.
- Reviewed fund documentation, and explained relevant aspects to help give them a better understanding of the funds and their strategies.
- Set up in-person meetings with the targeted fund managers to understand their investment strategy, background and organizational structure.
- Produced brief reports, which included our qualitative and quantitative analysis of each fund, making it easy to understand and compare.
- Discussed our views with the client and explained different scenarios and implications of each potential investment.

### **BENEFITS**

- Highly experienced New York based team works with the client, keeping the clients objectives at the forefront of the advisory process.
- Access to high quality hedge fund managers through Risk Advisors' industry network.
- Streamlined information gathering and fund analysis, providing client with actionable recommendations based on client's objectives.



## ROBERT L. WOOD JR.

Robert is a Managing Director at Risk Advisors Inc. and leads the Asset Allocation practice. Earlier in his career, Robert was a senior corporate and investment banker in Latin America with Chase Manhattan Bank and AIG. In the last twelve years, he has built a successful track record marketing Hedge Funds primarily in the United States and Brazil. Over his career, he has lived for extended periods of time in Brazil and has developed a special expertise on that country's alternative investment industry. Robert holds an MA in International Relations from the Johns Hopkins' School for Advanced International Studies, and received his BA from Duke University.



## SANJAY R. BHARWANI

Sanjay founded Risk Advisors Inc. to bring together markets professionals, risk management experts, and technologists to serve clients in financial markets. He actively consults with clients on risk management and technology related projects, and advises startup ventures focused on new ideas for the financial services industry. Previously, Sanjay was the Chief Information Officer at M. Safra & Co., a multi-strategy hedge fund focused on global macro and systematic trading strategies. Earlier in his career he focused on emerging markets debt at EXIS Consulting, a boutique financial markets advisory firm, and derivative valuations at Reval, a risk solutions provider. Sanjay received his MBA from the Wharton School at the University of Pennsylvania, and a Bachelors of Commerce from the University of Mumbai.

## ABOUT RISK ADVISORS

Risk Advisors Inc. is a consulting firm that understands the dynamics of financial markets and the inherent challenges in implementing a cohesive investing and risk management program across the enterprise. We offer deep industry knowledge, a rigorous process framework, and technology expertise to provide practical solutions for financial institutions and asset managers.