



Monthly Report
May

New reference standards for portfolios are debated in seminar

ANDIMA PROMOTED, ON MAY 15, THE SEMINAR REFERENCE STANDARDS FOR PORTFOLIOS: THE NEW IHFA AND THE PERSPECTIVES OF IMA. IN ADDITION TO THE EVALUATION OF THE THREE YEARS OF EXISTENCE OF IMA – ANDIMA MARKET INDEX, THE EVENT WAS ALSO MARKED BY THE RELEASE OF IHFA – ANDIMA HEDGE FUNDS INDEX. REGARDING IMA – A FAMILY OF FIXED INCOME INDEXES CALCULATED BASED ON THE INCOME OF THE MAIN PUBLIC SECURITIES IN MARKET - ITS CONTRIBUTION FOR EVALUATING A PORTION CONCERNING THE BEHAVIOR OF THE ASSETS THAT IS NOT EXPLAINED EXCLUSIVELY BY DI RATE VARIATION WAS HIGHLIGHTED. THE PARTICIPANTS OF THE SEMINAR ALSO HAD THE OPPORTUNITY TO KNOW THE METHODOLOGY OF IHFA, ONE OF THE MAIN PROJECTS OF THE ANDIMA'S ASSET MANAGERS COMMITTEE, FRUIT OF AN AGREEMENT OF THE ASSOCIATION WITH THE CVM – THE BRAZILIAN SEC, AND THAT ORIGINATED FROM THE DEMAND OF THE SEGMENT FOR THE CONSTRUCTION OF AN INDICATOR THAT COULD SERVE AS A PARAMETER FOR THE BEHAVIOR OF THE HEDGE FUNDS IN BRAZIL. ALTHOUGH WITH DISTINCT PURPOSES, BOTH IMA AS WELL AS IHFA REPRESENT INITIATIVES OF ANDIMA THAT SEEK TO OFFER TO THE FINANCIAL MARKET NEW STANDARDS THAT CAN BE USED AS REFERENCE FOR DIFFERENT PROFILES OF INVESTMENT PORTFOLIOS. THIS SYNOPSIS, THAT APPROACHES THE DEBATES THAT HAPPENED IN THE EVENT, ALSO PRESENTS AN INTERVIEW WITH THE CEO OF THE BANK OF NEW YORK MELLON IN BRAZIL, JOSÉ CARLOS DE OLIVEIRA.



IMA should contribute to risk control and performance evaluation

The creation of the new reference standards for portfolios, as well as the efforts for the mark to market of illiquid assets, is aligned with the objectives of ANDIMA to foment markets and to reduce uncertainties, having counted with the permanent support of the National Treasury, of CVM - Stock Exchange Commission and SPC - Pension Funds Secretariat.

It was in this context that IMA family of indexes appeared, in April 2005, as a development of an agreement accomplished between the Association and the National Treasury in 2000 for the development of IRF-M – Fixed Income Market Index. The initiative was originated in the perspective that, with the macro economical stabilization and trend of drops in the interest rates, the segment of fixed income should count with benchmarks that might be adapted to its strategies of investment. In the track of this process, still not fully consolidated, the interest of some institutional mandates was observed in strategies related to inflation indexes, once most of their actuarial goals were indexed to price indexes, and with a profile of longer maturity. In this context, some managers started to use the methodology of IRF-M applied to IGP-M indexed papers. Those managers got to reduce the comparisons of the actuarial goal with the DI Rate, starting to use the index as a “reference rate” and not a benchmark.

Such being the case, the creation of IMA, which took place at the time related to the recovery of the Brazil risk, helped to “eliminate CDI structure” of some institutional mandates, contemplating in a more natural way the risk related to the markets, conferring larger transparency to the managers' mandates and making easier the dialogue among managers, consultants and the customers. Nowadays, their main objectives are to become a return and risk reference for medium and long term investors; to foment the lengthening of terms for the portfolios of the market; to stimulate the primary and secondary segments of fixed income securities; and to allow for evaluating the manager's ability. Its importance is due to the need of measuring the capacity of the manager to provide superior results, particularly before the existence of fixed income assets whose risks are many times of a nature being different from the one of the DI Rate.

For contemplating, in great measure, the composition of the public debt in market, the evolution of the theoretical portfolio of IMA in the last three years can be compared with the change in the profile of the public debt observed in the period and that was marked by the increase of the fixed portions as well as those linked to the IPCA, in opposition to the reduction of the portions indexed to the



Selic Rate and IGP-M. In what refers to the evolution of the negotiations made on the SELIC system with securities that base the components of IMA, it is observed that, in spite of the maintenance of the predominance of the transactions with fixed income bonds, the increase of transactions with NTN-B, particularly starting from 2006, a year when the incomes produced by the public securities acquired by the foreign investors passed to be exempted of Income Tax.

The analysis of the risk-return relationship of IMA and of its components in the last 12 months shows that just IMA-C exceeded the return observed in the same period by IMA-S or by the DI Rate, considered of low market risk. In a longer horizon, of 48 months, IRF-M and IMA-B approached the return of these indicators, however, with a significantly higher risk. In spite of the trend of elevating the nominal interest rates in the short run, it is evaluated that the retaking of the path of reduction of interests in the medium term can motivate the substitution of benchmarks, a fact that can already be observed by the gradual increase in the number of funds that use the IMA family as a performance reference.

An important tool for using the index is the IMA Calculator, released by ANDIMA in the seminar, and that has as an objective to make possible for the user the creation of customized indexes having as base their sub-indexes. It allows choosing between market weights and weights defined by the user; to compare the customized index with other market benchmarks; to store in database the configurations of the indexes developed in it; and still to choose the format of the output files. The portfolio can be defined by using the market values of the indexes chosen as weights for the profitabilities of the sub-indexes, whose chosen weights are daily updated. Alternatively, it may be accomplished using weights set up by the user, that allow for the definition of the sub-indexes and their respective percentile values, constant during the whole analysis period.

Before the largest amount of net vertexes in the public debt and of the most complex dynamics related to the curves, the expectation is that there will be an increase in the manager's capacity for generating alpha, in other words, to add value through active management from the selection of actions, sectorial bets or tactical allocation. In this context, IMA will still be more useful in the future for controlling the risk of the portfolios, as well as for the performance attribution. However, some agents recommend caution in its use in function of the liquidity restrictions; of the tracking error being little controllable; of the strategies being very dependent of the placements of securities on the part of the Treasury; of IMA today still not being totally replicable, among other subjects.



The reduction in the interest rates foreseen for the next years, the smallest focus in CDI at the end of the month and the appearance of strategies of the Core and Core Plus type, in other words, that look for exceeding certain benchmark or to accomplish this task using other assets, in the analysts' evaluation, should favor the use of IMA also as a parameter for the industry of investment funds. Among the next challenges, there stands out the creation of indexes that incorporate the risk of private credit of assets such as CDB and debentures.

Aware of those needs, in addition to studying the pricing of CDB, ANDIMA already plans the creation of the Index of Debentures, which will be calculated from the assets priced daily by the Association; the creation of the Index of Constant Duration (IDC), which will be calculated from the points of the forward interest rate structure, calculated daily by ANDIMA; and the elaboration of a publication on the possible ways of using the IMA, demanded by some institutional investors.

There was also submitted in the event a panorama regarding the policies of investments related to the Closed Entities of Complementary Social Security under the optics of the risk/return and cost/benefit. The analysis of 922 existing plans of benefits in 2008 appointed for a reduction in the risk assumed in the portfolios of fixed income and for an increase in the portion of companies with practices of good governance in the portfolio of variable income. Regarding the profitability objectives, about 75% of the researched registrations indicated the use of the actuarial minimum rate adopted as being INPC + 6%. The use of IGP-M and IPCA, that correct an important portion of the public debt, still appears in a residual way in this function. In what refers to the reference index used for the fixed income portfolios, in spite of 57% of the registrations appointing for utilization of DI or SELIC Rate, the sub-indexes of IMA already answer for 31% of the total.

As for the regulation of the social security segment, it stands out the Resolution no. 3.456, of CMN – National Monetary Council, dated 2007, that set forth the IMA and its sub-indexes among the alternatives for evaluating the performance of the fund or the portfolio administered for ends of collecting the performance fee of the fixed income portfolios of the plans of benefits. The said fee will be due whenever the amount concerning the results of the fund or the portfolio exceeds the valorization of, at least, 100% of the reference index and exceeds the face value of the initial application. It also deserves distinction the edition of the Joint Decision CVM / SPC no. 11 / 2007, which indicated IHF and IMA and their sub-



indexes as a reference for paying the performance fee of the investment funds and the investment funds in quotas of investment funds classified as multimarket. In this case, the objective is to measure what is the benefit that the invested fund adds to the management of the plan of benefits, and to set up coherence between the collected performance fee and the strategy used by the fund.

At the end of the debate, the participants evaluated that the transition of CDI to IMA should be gradual, observing that the reduced liquidity of the secondary market hinders the process related to increasing the maturity of the portfolios and, consequently, the use of compatible reference standards with longer terms. Such being the case, one of the objectives of the fixed income market should be the increase of its depth and the presence of agents with vision and capacity to act. Although the great concentration of this market favors the buy and hold strategy, this is not just a Brazilian phenomenon, but international. It also should stand out the importance of the availability of data on the fixed income market, what has been one of the main focuses of the ANDIMA's work. The discussants also considered important to attract the investor for the fixed income private securities and to develop the derivatives, with the assumption of short positions and the fixed income securities lending.

Funds of the IHFA sample with better performance generated alpha

The evaluation related to the origin and evolution of the industry of hedge funds in the world appoints for a growth in the order of 25% a year since the eighties; thus, in the end of 2007, the segment reached ten thousand hedge funds, with total net worth of US\$ 1.87 trillion. Although there is not consensus about the definition of the term hedge funds, these funds are usually characterized for not adopting strategies of the long only type, unlike of what happens in Brazil, since they are not subject to the regulation in its own jurisdiction. Iosco and SEC, however, already study to set up larger control on these funds.

In the specific case of Brazil, it was the Instruction CVM no. 409 that, when regulating the Multimarket class, opened the doors for the industry of hedge funds. The growth of the segment in the country was attributed to the continuous reduction of the real interest rates, what lead to the need of looking for larger profitability from the sophistication of the investments. In what refers to the regulation, the possibility conferred to the Closed Entities of Complemental Social Security of investing up to 3% of their technical reserves in multimarket funds and the authorization so that the investment funds may invest in assets abroad should continue stimulating this movement, and contribute for a favorable perspective in the sector.



Such being the case, before the growth and stability of this industry, as well as of the need for comparison based on an indicator that could serve as a parameter for the behavior of the hedge funds in Brazil, ANDIMA released IHFA, made possible through the agreement between the Association and CVM seeking the data collection. In accordance with the participants, the index should pursue the following objectives: representing all the options of investments available within each strategy; treating the available data quickly, consistently and trusty; be built based on a methodology of a clear, objective and previously discussed construction; be investible; and present a stable portfolio, with low turnover of the index portfolio.

In order to integrate the sample of IHFA, the fund should belong to the Multimarket class, because its calculation cannot be subjective or discretionary. In March 2008, the industry was made up by 8.240 funds (FIF and FIC-FI registered in CVM), with equity of R\$ 1.8 trillion. Of these, 5.103 (R\$ 500 billion) were classified as Multimarket. In the last three years, it was the segment that most won space in the industry of funds, elevating its share from 22% to 28% of the total of the industry, although, more recently, redemptions have been observed in these funds because of the volatility provoked by the international crisis and the low familiarity of the investors with these types of funds in the country.

The application of the criteria for mounting the theoretical portfolio of IHFA based on the quarterly re-balancing occurred on April 1, 2008, of a total of 8.240 funds, resulted in a final sample composed by 103 funds. The index is linked by the method of Laspeyres, and, according to it, the quotas of the funds are considered by the theoretical amounts of the base period. The aggregate statistics of the fourth quarter of 2007 and of the first and second quarters of 2008 appoint for an increase in the number of funds and managers integrating the sample and a reduction in the average net worth and the minimum volatility of cut (first quartile), a period marked by the most significant effects of the international crisis, that especially reached the class of multimarket funds.

The analysis related to the turnover concerning the components of the sample appoints that, during three quarters, 127 funds integrated the portfolio of IHFA. Of these, 57% (72 funds) stayed in the index during the three analyzed quarters, and these 72 funds represent, on average, about 76% of the net equity of the quarterly portfolios. In this period, a high correlation was also observed between IHFA and other similar indexes, such as IFMM UBS Pactual, Risk Office NR and *Arsenal Composto Não Investível*. Aware of the dynamism of this industry and the lack of benchmarks in the segment, ANDIMA already plans to develop, soon, starting from the open funds, the sub-indexes of IHFA, in such a way to reflect the performance of the main strategies used by



these funds in Brazil. The challenge, in this case, will be to classify the strategies of the funds that present low correlation among them.

At the end of the event, a comparative study between the funds integrating the sample of IHFA and the institutional multimarket funds taking part in the database of IGI-Abrapp was presented. The objective of the analysis was to evaluate the performance of the segment of multimarket funds and to verify the used strategies. Although they have presented greater volatility, the 25% of the funds of the sample of IHFA considered with better performance were indeed the only ones to generate alpha for their quotaholders; in other words, they created an added value for practicing an active management that generated superior profitability to the systematic return of market (beta). The research allowed to conclude, therefore, that the funds of the sample of IHFA indeed behaved as hedge funds, adopting frequent changes of allocation tactics, and only the funds with a better performance were effectively capable for generating alpha.

Interview – José Carlos Oliveira

IN INTERVIEW TO THE SINOPSE ANDIMA [SYNOPSIS ANDIMA], THE CEO OF THE BANK OF NEW YORK MELLON IN BRAZIL, JOSÉ CARLOS OLIVEIRA, ANALYZES THE SEGMENT OF HEDGE FUNDS IN THE COUNTRY.

What is the importance related to the development of reference indicators, such as IMA and IHFA for the administered portfolios and investment funds?

Both indexes are a good indicator for each manager's individual performance in relation to the universe of funds in the same category.

For some time, people have been talking about the difficulty of ending the so-called culture of DI, that caused that the interbank rate became the main benchmark to measure the behavior of assets in the country. In your opinion, which other indicator could accomplish this function?

Even with the perspectives of increase in the prime interest rate in the next meetings of Copom (in order to refrain the growth of the inflation), in the long run, due to the improvement of the foundations, the trend is that the Brazilian yield curve will have a smaller premium in the future. This effect will cause the investors to pay more attention to the face value returns of the assets, because the remuneration of the capital at CDI will no more be so attractive. The reference indicators, as an example of industries of funds that are more developed, should substitute CDI in the role of a benchmark for the performance of the funds.



In your estimation, what are the main lessons that the last external crisis leaves for industry of hedge funds in Brazil and what we should expect in relation to the development of this industry in the country for the next years?

We had several years of bull market, without any more deepened crisis, a fact that facilitated the managers' of hedge funds life. In these years it was difficult to identify who had major management capacity, because in most of the cases it paid better to who took more risk. The recent credit crisis was what more caused damages to the hedge funds in the last years and, in some cases, it got to test the limits of risk of the funds. The positive side of the moment of greater volatility that we have been passing since the middle of the second quarter of the last year resides in the investors' culture. They were used to rare periods of negative monthly returns, and experimented in this period a reality more in line with the risks inherent to the multimarket products.

The trend is that the industry of funds in Brazil will move to categories of funds that are better defined as the managers increase the degree of specialization of their strategies. In such a way, we will still see specialist funds doing operations not being yet widespread in the domestic market emerging with the maturation of the industry. The recent alteration in the legislation, allowing the hedge funds to invest up to 20% of their equity in assets abroad (up to 100% in the case of super qualified funds), is a strong indicator for such an evolution.