



Monthly Report July

Uncertainties still compromise the profitability of the assets

ONE YEAR HAS PASSED SINCE THE BEGINNING OF THE SUBPRIME CRISIS, WITH THE CONSEQUENT FEAR OF THE AGENTS WITH RESPECT TO THE START OF A SYSTEMATIC CRISIS IN THE FINANCIAL SYSTEM, AND THERE STILL REMAINS AN INSECURE ENVIROMENT CONCERNING ITS DEPTH AND SPREAD DEGREE, WHAT CONTRIBUTED TO THE EXISTENCE OF AN ENVIRONMENT OF AVERSION TO THE RISK IN THE MAIN INTERNATIONAL MARKETS. THIS SITUATION, WHICH NOW INCORPORATED UNCERTAINTIES DUE TO THE INCREASE OF THE PRICES OF FOOD AND PETROLEUM WORLDWIDE, IT REVERTED THE VIRTUOUS GROWING CIRCLE OF THE SEGMENT, THAT SO FAR WAS PROVIDING A HIGHER DIVERSIFICATION OF THE INVESTORS BASE AND TRADED ASSETS, AS THE RESULT OF THE ADOPTION OF A MORE CONSERVATIVE POSTURE BY THE AGENTS WITH RESPECT TO THE EXPOSURE TO RISKS. IN BRAZIL, SUCH REALITY IS MORE VISIBLE WHEN ANALYZING THE BEHAVIOR OF PROFITABILITY OF THE ASSETS IN SUCH PERIOD AND THE RELOCATION OF RESOURCES AMONGST THE SEVERAL KINDS OF INVESTMENTS.

Financial system

A. Variable income

The investments in Stock Exchanges were the first ones to suffer the negative impacts of the news related to the crisis of North-American subprime. In Brazil, despite the arguments of decoupling of the emerging markets, there was an expressive reduction of the profitability of the Bovespa index and the volumes



negotiated in the segment. In the first semester of 2008, the monthly average performance of Ibovespa was of 0.57%, much lower than the pre-crisis periods (in the same period of 2007, such average yield was of 3.41%), what gave rise to the withdrawal of foreign investors resources between June/07 and June/08 in the amount of R\$ 10.7 billion.

B. Fixed income

In the fixed income market, the reversal of the virtuous scenery interrupted the process of reduction of the interest rates in September/07 and caused successive increases of the Selic Rate as of April/08. Thus, the worsening of the risk/return perception compromised the performance of the prefixed investments. In 2008, IRF-M (index measuring the profitability of the marked to market portfolio of the LTN and NTN-F) yield less than the short term benchmarks - Selic Rate and DI -, accumulating nearly 3.39% in the semester.

The aversion to the prefixed exposure reflected in the difficulties of placing such securities as of the second semester of 2007. The participation of the IRF-M portfolio in the total of the IMA - ANDIMA Market Index portfolio reduced from 40% (June/07) to 31.24% (position on July 28, 2008). It must be pointed out, however, that despite the crisis in the north-american financial system, the deterioration of the expectations of short term inflation occurred in the same period, and the possibility of loss of profitability in actual terms reinforce the preventive movement.

The confirmation of the perspective of increase of short and medium terms inflation is what is sustaining the performance of IMA-C and its subindexes (stock at market prices of NTN-C). In the first seven months of the year, the profitability of IMA-C (bonds with up to five years) was more expressive between the IMA portfolio, recording 12.47% in the period. The variation of its index, IGP-M, between January and July, was in the amount of 15.12%, what explains in great part its route.

The profitability of the portfolio containing papers indexed to the IPCA (NTN-B) was compromised by the worsening of the perception of real interest rates at long term, in face of the evaluation of the risks of such new scenery. The extension of the terms of such securities was interrupted. The duration of the IMA-B, which was of 68.8 months in June/2007, is at the present moment in 66.5 months (position in June/08).



The instability observed in the last 12 months is reinforcing the preventive posture of the Brazilian investors, with impacts on the negotiation volumes. At the distribution of the return of IMA-B, which indicates the minimum returns, of the first quartile, the third quartile and the maximum in each quarter, it can be observed a greater amplitude in the third quarter of 2007. The greater volatility of such portfolio indicated an increase of the possibility of loss as from the third quarter of 2007, what caused a substantial reduction of the amount of NTN-B negotiated in the secondary market (despite the returns of the portfolio being concentrated around the median throughout time). Apparently, the use of other strategies that may differentiate in an aversion to the risk environment, at least with respect to the public securities market, were not effective. The negotiated volumes were unable to recover the numbers of the period previous to the subprime crisis.

In the private securities market, the change in function of the worsening of the scenery took place in the scope of an expressive increase of the credit in economy, which in the last five years grew more than ten percent points of GDP. The strong reduction of liquidity in the international market as from July/07, worsened by the implementation of the compulsory over the deposits of the leasing companies in financial institutions in January/08, caused a decrease in the issuances of debentures in such segment, which main purpose was to finance credit operations. It compromised the funding capacity of the financial institutions in face of a greater demand.

Thus, in the first semester of 2008, it was verified a redirection to funding through CDB – Bank Deposit Certificates, in particular those indexed at the DI floating rate. The need to create funding to maintain the credit offer increased the return rate and provided more attraction to such papers, which total stock increased 37% up to the begin of July, in excess of R\$ 500 billion, pursuant to data of Cetip. The demand by such asset increased expressively, with reflex in the amounts issued, which monthly average volumes doubled in comparison with the same period of 2007.

Such expansion caused a significant relocation of resources in the fixed income market, since it stimulated investors to redirect to more conservative investment options. Between April and June 2008, period of greater growth of the stock of CDB, was recorded an exit in the investment funds industry of nearly R\$ 21 billion, which probably had direct relation with the growth of such asset in the fixed income market.



The maintenance of a warm demand for credit in the domestic market is also sustaining other windows of opportunity in securities originated from the assignment of credit. In 2008, the stock of papers representing such assets grew nearly 42%, in particular the FIDC – Investment Funds in Credit Rights, which represent nearly 49% of the total of such amount.

In general, the average profile of the investors of fixed income in the Brazilian market shows a great sensitivity to a more volatile scenery. In the segment of the investment funds, only the investments in the category of fixed income corresponded to an output of resources of nearly R\$ 46 billion in the last 12 months, from which R\$ 36 billion only in the second semester of 2007. Now, the multimarket funds registered negative liquid funding of nearly R\$ 5.7 billion in the same period, however with different sceneries between the two last semesters (entry of R\$ 15.7 billion in the second semester of 2007 in face of an output of R\$ 21.5 billion in the first semester of 2008).

AHFI route

The greater instability observed in the last 12 months compromised the performance of the investments searching return above the short term references. However, it can be noted a recovery in the period from April to June/08 of the investments with greater risk, with the purpose of receiving returns above the market average. Using the IHFA – ANDIMA Hedge Funds Index as index for this segment of the funds industry, it is verified that, to the contrary of the first semester of 2008, its performance was kept above the short term benchmark – ID rate. Such performance in the second quarter/2008 may be attributed to the evaluation of the investment grade to the Brazilian economy, what helped the improvement of the performance of the Stock Exchange and a few segments of the interests market. Besides, the positioning in the valuation of the Brazilian currency was successful, since real went from -8.99% against -1.25% in the previous quarter. However, before such movement configuring as a trend to the rest of the year, the extreme worsening of the results of the Stock Exchange on July (-8.48%) reverted the performance of the index, which up to the 29th had varied -0.36% in the period.



Interview – Gustavo Coelho

The market is more mature

IN INTERVIEW TO SYNOPSIS ANDIMA, THE RESPONSIBLE FOR THE ALLOCATION DEPARTMENT OF ARSENAL INVESTIMENTOS, GUSTAVO COELHO, COMMENTS ON THE STRATEGY CHANGES OCCURRED IN THE FIXED AND VARIABLE INCOME MARKETS – IN PARTICULAR IN THE MULTIMARKET SEGMENT -, IN FUNCTION OF THE SCENERY OF AVERSION TO RISK VERIFIED LAST YEAR.

The existence of a scenery of aversion to the risk in the last year caused a change of strategy of good part of the market agents to a more conservative profile. How did this change reflect in the segments of fixed and variable income?

Concerning the variable income segment, the movement was more subtle than in previous crisis, what indicates that the culture of the investor is improving. Differently from what took place up to a few years ago, the drafts of individuals were less expressive. It seems that the Brazilian investor is learning that it is better to enter the market at the moment of realization and not at the peak of valuation of the Stock Exchange.

Now, in the fixed income segment, in particular in the multimarket funds industry, it is required a separate analysis of each strategy. Observing the behavior of the multimarket indexes, it can be verified that there were strategies whose profitability was below the CDI, while others were able to keep its profitability above the index. Due to the trend of banks, in particular the first line banks, paying more for the BDC fundings, it occurred a migration to such investments, which volatility is lower. Besides, I realized a greater demand for credit products, such as funds, products of independent managers and FIDC, among others. In general, it was an important learning to the Brazilian market, both to investor, who began to understand the effective risks of the assets, and to the allocator, who now knows better its clients. Thus, both are capable of structuring more balanced portfolios from now on.



An analysis of the IHFA in 2008 shows that the hedge funds industry, despite the losses accumulated since 2007, presented a better performance in the second quarter in comparison to the DI. Which factors can be attributed to such performance?

The separation of IHFA in indexes by strategy, that ANDIMA is planning, will be very important, since it will enable the evaluation of the different rankings. Some funds ranked as arbitration presented, in particular in the last 12 months, a relevant performance above CDI, in comparison to the other funds – macro, equity and hedge – in the same period. However, in the last quarter, such funds reach better results, thanks to the investment grade obtained by Brazil and to a less cloudy scenery. This because, in theory, the hedge funds manager cannot seek results only when the scenery is positive. The important is to be able to visualize the market trend. Now, the visibility is better; now, there are more possibilities of obtaining better performances.

After the first moment of the crisis, it could be noted that the hedge funds are consolidating as alternative of investment in the Brazilian market. Which is your evaluation with respect to the evolution of the hedge funds segment in Brazil?

Although a few funds have a long history, the hedge funds industry is relatively new in Brazil – the major part of the funds have at most five years. During such period, predominated an optimistic scenery, with strong flow of capitals, what favored the performance earnings. In the last 12 months, for the first time after its consolidation, the segment experimented a longer instability period. Actually, it may be affirmed that the actual game of the multimarket funds in Brazil began in August/2007, to the extent that we leave a scenery with a much defined trend. The crisis provided the investors with more tools to analyze where it is investing, and to the manager, more efficiency.

It is possible to relate such hedge funds market growth in Brazil to a bigger maturity of investor? Which are the preconditions to the domestic investors being less sensitive to the short term volatility?

In fact, the market is more mature, but there is still a long way to go. Investor needs to ask himself at all times, and not only in the moments of crisis, whether his allocation of resources is adequate to the desired return and to the risk it is willing to assume. The culture of evaluation of the risk/return relation, which is not yet disseminated with the final investor, needs to be better developed, so that there are no such harsh draft movements in function of eventual instabilities of the scenery.