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Brazil begins push to widen Bovespa's appeal

By Samantha Pearson in São Paulo

As the sun sets outside the top-floor office of Edemir Pinto, head of Brazil's stock and futures exchange operator BM&FBovespa, the familiar roar of helicopters fills São Paulo's sky as the wealthy begin their commute home. For some, it may be days before they reach street level, traversing constantly between skyscraper office blocks and penthouse apartments.

São Paulo now has the biggest helicopter fleet among any city in the world, according to the country's pilot association, Abraphe – a sign not only of the chronic traffic jams below but of the country's growing legion of multimillionaires.

For Mr Pinto and his colleagues, it is yet another reminder of why the country's Bovespa stock market should be thriving.

After one of Brazil's best decades of economic growth and a private equity boom that has poured billions of dollars into the pockets of company shareholders, the stock exchange's pool of potential investors has never been larger.

Private equity funds made the highest number of acquisitions in Brazil on record last year, dispersing a total of $1.09bn via 25 deals, according to Dealogic.

Meanwhile, total assets under management in Brazil have surged from R$936bn in 2006 to over R$2.4tn in July this year, according to the Brazilian Financial and Capital Markets Association, Anbima.

Historically low interest rates have also helped lure Brazilians away from local government bonds, offering the Bovespa one of its best chances yet to increase its base of domestic investors and wean itself off volatile foreign capital flows.

"Brazilians have an investment culture that is based on fixed income so it is very difficult to persuade them to put money into variable income products that carry risk," says Mr Pinto.

However, as Brazil's wealthy and institutional investors such as pension funds venture outside the country's government bond markets, many are turning their attention abroad instead, say investment funds.

A case in point is Algebris. The London-based hedge fund with just under $1bn in assets told the Financial Times it plans to launch its first onshore fund in Brazil this month in partnership with local manager Fundamenta. The new fund, which will invest in the so-called contingent convertible bonds, or cocos, of banks largely based in the US and Europe, is expected to attract $200m within a year and eventually draw in institutional investors.

"Wealth has exploded over the past few years in Brazil," says Algebris's Massimo Massimilla, who is leading the Brazil fund. "While in the past Brazilians would have invested exclusively in local bonds the scenario is changing now."

A 21 per cent slump in the Brazilian real against the dollar since the beginning of 2012 has also encouraged the country's traditionally inward-looking investors finally to diversify abroad, Mr Massimilla says.

Cocos, which typically offer coupons ranging from between 8 to 9 per cent depending on the perceived creditworthiness of the issuing bank, automatically convert to equity if the bank's capital dips below a certain point.

They have been popular among regulators keen to avoid any further taxpayer-backed bailouts and proved a profitable investment strategy so far for Algebris – its parent coco fund reported a 56 per cent return in 2012.

Brazilian investors are also looking to diversify into US and European equities. Last month, the Rio de Janeiro-based fund manager STK Capital launched an onshore international equities fund, giving Brazilians an easy way to invest in the stock of companies such as Diageo and Visa.

"Brazil has had an amazing run over the past eight years or so and now many people are thinking of diversifying and balancing their wealth between Brazil and abroad," said Daniel Grozdea, a partner at STK.

However, Brazilians' long-overdue diversification of their assets means the stock exchange will have to work even harder to persuade domestic investors to put their newly-earned millions in the Bovespa.

Part of the battle lies in giving equity investors more choice – commodities-related stocks still represent more than half of the Bovespa index.

But it is a vicious circle. Although as many as 26 companies have registered plans to go public this year, their ability to list largely depends on the mood of foreign investors, which represent about 70 per cent of demand for initial public offerings in the country, says Mr Pinto.

"The Brazilian market has a spectacular potential . . . but Brazilians alone can't make these IPOs happen," he says.

While the abrupt end to the country's recent economic boom and political uncertainty have been blamed for scaring off foreign investors, indications the US Federal Reserve will taper its quantitative easing programme have also hit the market.

In a bid to increase its domestic base of investors, Mr Pinto says he is looking to introduce the stock exchange's first ever incentive scheme for brokerages to encourage them to take a more proactive approach to finding new equity investors.

In the meantime, though, the Bovespa's biggest appeal is likely to be its price, says Luciano Rostagno, chief strategist at Banco Mizuho in São Paulo. After slumping nearly 30 per cent between January and the beginning of July, the index has since risen 15 per cent as bargain-hunters snap up cheap stocks.

"In this case, the depreciation of the real has also had a positive effect," said Mr Rostagno. "Shares of exporters have become more attractive and the weak real has also made stocks cheaper for foreign investors."

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