For Many US Funds, Only Back In Brazil In Mid-2009

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SAO PAULO (Dow Jones)--It used to be that Brazil was the darling of emerging markets in the Americas, but the global financial market maelstrom and economic slowdown have now prompted investors to turn their back on the country.

Brazil's Ibovespa stock index has lost more than 40,000 points since May 28, when it reached an historic intraday high of 73,920 points. That's when foreign investors rewarded the country with a fresh infusion of capital after Fitch and Standard & Poor's gave the country its much sought-after title of investment grade.

Most investors still love the Brazil story, although for now they prefer to sit on the sidelines.

Brazil is energy self-sufficient in both ethanol and petroleum. It's a huge commodities producer, but also boasts significant manufacturing and services sectors, including a sophisticated banking industry that's free of the "toxic assets" that have sunk many financials in the U.S. and Western Europe. It also sports a large and growing consumer base.

Nevertheless, its attraction has waned, and U.S. asset managers that don't have to invest in Latin America's biggest economies have no plans to come back for several months.

"As late as the third quarter we still had some emerging market assets ... but we sold them all," said Kevin Mahn, chief investment officer at Hennion & Walsh Asset Management, Inc. owners of the $170 million SmarthGrowth fund of funds. "We have no emerging market allocations and won't consider them, including Brazil, until the first quarter of 2009."

Whether investors are exposed to Brazil through exchange traded funds, American Depositary receipts, or investing directly in the Bovespa, Brazilian equities have suffered net outflows of foreign capital since June.

The Bovespa suspended trading six times this year. Mostly in the last two months. The Bovespa had net outflows of 3.3 billion Brazilian reals ($1.4 billion) so far in October, and BRL21.7 billion so far this year, compared with BRL12.3 billion in 2007 and BRL6.1 billion in 2006, according to the Bovespa.

Commodity prices have fallen sharply, with benchmark crude prices down more than half since their July highs, and base metals prices also down significantly.

The global dollar liquidity squeeze and outlook for slower growth have undercut prices for Brazilian commodities - whether it's ethanol, soybeans or beef. And slower economic growth in Asia - particularly China - means less demand, for example, for Brazilian steel and iron-ore from major companies like Vale do Rio Doce (RIO), whose shares have lost 56% of their value over the last 12 months. Brazil's key Ibovespa stock index is down 51% over the same stretch.

Brazil's economy might be fundamentally sound, and bolstered by just more than $200 billion in foreign exchange reserves - but a recession in Europe and the U.S. and slower growth in China, are prompting analysts to reckon with Brazilian economic growth of 2.5% in 2009, half of the 5% expected this year.

That's not much for dedicated emerging market funds to lean on, no matter how much they like Brazil's long term prospects, says Ed Kuczma, investment analyst for the $77 million Van Eck Emerging Markets Fund (EMRCX).

"It's been a very rough year for us. We get calls everyday from clients asking us if we can reposition the portfolio, but unless you're in cash, it's tough to position an equity fund defensively, especially an emerging markets one," Kuczma said.

Around 14% of the fund is allocated to Brazilian assets, either directly into small companies, or through ETFs. The fund's down 48% year-to-date as of September 30, 2008.

"We are neutral on Brazil at this point and only looking at smaller names that are cash rich and have no short term debt," Kuczma said.

"We have the cash, but Brazil is a moving target and with risk aversion like this around the globe, emerging markets are the first thing to go," he said.

The fund holds small names like clothing retailer Hering (HGTX3.BR) and medical supply company Cremer SA (CREM3.BR), both underperforming the index year-to-date.

Joe Clark, director at the Indiana based $200 million asset management firm, Financial Enhancement LLC, said he is actively trading a dwindling number of Brazilian assets through holdings in the iShares MSCI Brazil Index ETF (EWZ).

"We sold out of all emerging markets in November and bailed out of Brazil in early September once Lehman Brothers went bankrupt," said Clark.

The $2.7 billion Brazil iShares ETF is down to $29.94, from a 52-week high of $102.21.

"We are sitting on at least 40% cash for our clients and we will wade in and out of Brazil if EWZ looks like it can go to $34 a share. We'd be buyers at that level," Clark said, "but that doesn't mean we won't wade out fast."

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