

Focus
on the pursuit
of excellence

Balancing
preservation with the
realization of wealth

Integrated
partnerships for
enhanced performance

Flexibility
to navigate an ever-evolving
investment environment

Leverage
of superior internal and
external intellectual resources

A perfect synergy

Combining world-class partnerships, a wealth of expertise and the like-minded pursuit of excellence, to create unique investment products that far exceed the sum of their parts.

T: +27 21 976 1012 F: +27 21 976 1096
www.edge.co.za

EDGE
capital

CO-OPERATION. INNOVATION. CREATION

THE EDGE IN HEDGE FUNDS

Edge Capital (Pty) Ltd is a licensed hedge fund Financial Services Provider

Wobbly

Hedge fund returns were patchy in 2008 but ahead of overseas

Hedge funds were marketed to pension funds as the shock absorbers of an investment portfolio.

When equities were in trouble, institutions could always rely on hedge funds to provide uncorrelated returns — and if well managed they should not give negative returns in a poor market.

Some SA funds have passed this test with flying colours — examples include Fairtree, Coronation Multistrategy and Oryx. And with the average international hedge fund producing a negative return of 18,3%, the overall performance of the SA funds was quite credible.

The Symmetry SA Hedge Fund survey is the only publicly available single hedge fund survey — though as a leftover from the untransparent early days of hedge funds another survey is available only to people prepared to fork out a large subscription.

According to Symmetry, the best performers were the fixed interest funds with an average return of 12,8%.

The market neutral fund is the classical hedge funds which offsets long (positive) positions with an almost identical amount of shorts. The average return was 10,4% and just three of the funds gave a negative return.

Long/short equity funds usually have a

WHAT IT MEANS

- > Greater disclosure is coming to hedge funds
- > At least R1bn was withdrawn last year

directional bias in favour of the market. Investors in these funds should not be surprised if these funds make a negative return when markets tank — and tank might even be an understatement for a 25,7% loss in 2008.

A modest loss of 0,9% was credible, though there was a wide dispersion of returns. Index funds would be jealous of the way the Praesidium SA Hedge Fund's loss of 25,2% almost exactly matched the JSE itself.

It was also a rough year for the most highly regarded team in the hedge fund industry,

“With hindsight we could all have done even better with less directional exposure to the market”

— DAVID BACHER



Hedy Zantman



Natty Zantman

Edwin Schultz Proving large managers can run hedge funds

Peregrine Capital — its three long/short funds were all down 13%. Yet the T-Cap Solario's 30,9% return shows that there are a few funds that deserve the generous fees hedge funds pay themselves — namely up to 2% fixed fees plus 20% of all positive returns.

Multistrategy funds should be best placed to weather the storm of a weak market. Yet only one of the five funds in the category, Genesis Hedge Fund made money for its clients, with a 19,5% return.

One of the most famous funds in the industry, the BlueAlpha Mayflower Fund ended up 15,3% down, after a drop of 18% in July — it doubled up its bet on resources at exactly the wrong time. But with R900m under management, it lives to fight another day.

"With hindsight we could all have done even better with less directional exposure to the market," says David Bacher, chief investment officer of Brait Specialised Funds, a fund of hedge funds business. "Many funds didn't anticipate how severely the market direction would change in the middle of the year, with financials recovering and resources slumping. But overall, with the market down 26%, it was a great result."

Bacher says the manager line-up would have been different if he had started with a clean sheet of paper. FRAIM, the

Momentum group's fund of hedge funds, was lucky enough to start in November 2007 when there were signs of a bear market: 30% of the fund was invested in fixed income funds.

Theron van Wyk, who manages the TriAlpha fund of hedge funds suite says that the SA hedge fund industry (which only got traction in 2003) has lived most of its life in a bull market. "We identified that, with the industry trying to ride the bull, there was a gap for a product focused on fixed income."

Carla de Waal, a researcher at Novare believes that there have been R1bn of net withdrawals from the industry — while general equity funds lost R8,5bn in just nine months.

According to the *Financial Times* the hedge fund industry worldwide has shrunk by 50% to about US\$1-trillion. This is a combination of withdrawals (about US\$250bn in 2008) and negative performance.

Esmarie Strydom, head of Blue Ink, Sanlam's fund of hedge funds group, says it is vital that clients decide upfront how much risk they can tolerate so they can invest in the right vehicle — in Blue Ink's case conservative, moderate and aggressive funds. Unlike unit trusts, institutions form the bedrock of hedge fund investment. An international survey shows

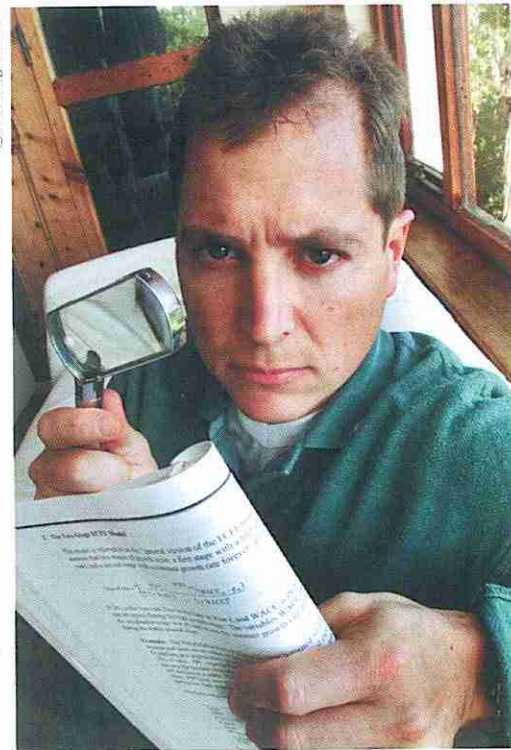
that globally most pension funds take a long-term view of their hedge fund investments (see page 9). And local institutions will be similar.

Cadiz Wealth MD Evan Jones says that over the past 15 years hedge funds have created a very clear space in the investment world. "It should not be underestimated how difficult that task was given that outside of the conventional asset space (cash, bonds, property and equity) there has been very little development of new asset classes — hedge funds achieved exactly that."

There have been some instances where hedge funds have imploded — the poster boy being Long Term Capital Management in 1998 which collapsed because of emerging market jitters after Russia defaulted.

In SA, the only collapse has been Evercrest, which had been a conservative fund. However, it decided it needed to turbocharge returns through taking on borrowings to fund a short position in Sanlam, just when the share rose by 17%.

The word opaque is still associated with hedge funds. Jones, who is launching a multistrategy hedge fund on March 1,



© Sunday Times

Evan Jones Insight improving



Hetty Zantman

Mike Kirsten Time for a commodity fund

concedes that one of the main criticisms that has been levelled at hedge funds is the limited insight investors and regulators have had over their activities. Internationally, because of solid uncorrelated returns in the 1990s they were allowed to grow without regulatory oversight.

The major markets compensated for this by requiring "qualified investors" to be the entrance hurdle to investing.

SA transparency and self regulation are well ahead of those in most jurisdictions.

Rich personal investors, who were the anchor investors overseas, played a much smaller role in SA.

The dominant investors have been funds of hedge funds, who were in effect the agents for pension funds — even giant funds such as Eskom invest through funds of funds rather than directly. They have also demanded that funds have an independent administrator, and prime brokers also play an important role in ensuring that funds keep to their mandates.

It is notable that Evercrest was in transition between two prime brokers when it collapsed. Jones says that in a rising market many shortcomings were also tolerated. People seemed to be setting up their own hedge funds in garages or even on the beach at Hout Bay.

As the SEI survey indicates, the focus will be on the search for institutional quality. Byron Green, head of the Caveo fund of hedge funds group, says though he likes to see experienced hands run-

ning hedge funds, he does not like the "lone wolves" who have nobody in the office to bounce ideas off.

One of Bacher's tasks has been to review the quality of Brait's fund of funds portfolio after it had lost more than R1bn to competitors, primarily to Edge Capital.

"We have reduced our exposure to in-house Brait funds over time and we will keep raising the bar for the funds in which we invest," says Bacher.

This does not mean hedge funds are closed to entrepreneurs.

Mike Kirsten of Edge Capital, now SA's largest fund of hedge funds group, says that start-ups can subcontract all the noncore functions to independent administrators and others.

A number of new strategies are being implemented out, some of which do not look like hedge funds to the naked eye — for example customised credit. This is a mini finance house which lends money when the banks are not prepared to do so (and these days quite a lot of good quality businesses cannot get conventional loans). St John Bungey at Praesidium Capital is the pioneer of this strategy. Futuregrowth has also

come into the space and it has organised R600m in securitised taxi finance.

Simon Peile at Sygnia Asset Management says the problem is that not all the risks are understandable — they are "unknown unknowns" as they used to say in the Bush era.

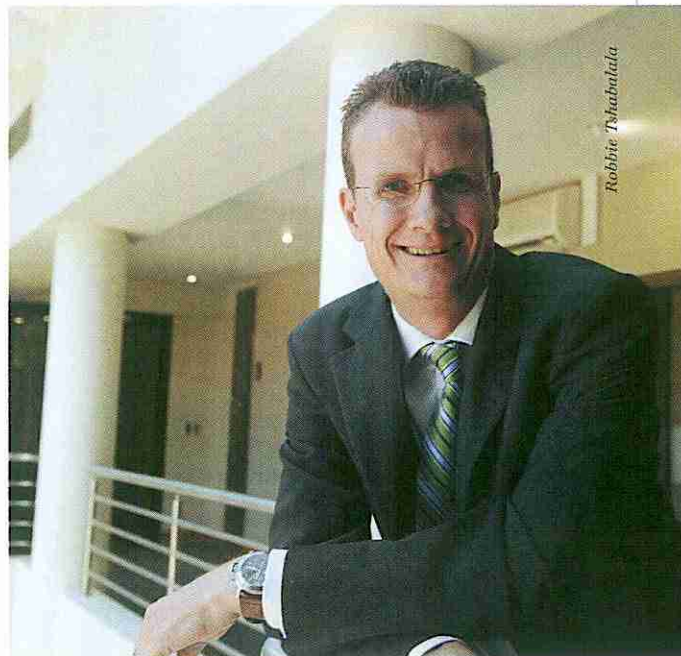
Kirsten says a commodity fund, similar to a global macro fund, is an obvious gap in SA. But there are few instruments to manage one effectively — there is no commodity futures market to speak of.

It is also important not to paint all hedge funds with the same brush. Old Mutual's Absolute Return boutique hedge funds are conservative with perhaps a little too much emphasis on risk for many investors with lots of small carefully controlled bets. But this insured that its Volatility Arbitrage Fund provided a solid 9,8% return over three years.

Its racier sister the Market Neutral Fund, which has larger higher-conviction bets was down 9,4% for the year and up just 3,5% over three years — but the outcome of both funds is not unexpected.

Kirsten says the good news for funds of hedge funds is that funds which were previously closed to new business have reopened, after the recent withdrawals.

James Gilfillan, manager of the Alpha fund of funds range, says that choosing



Robbie Tshabalala

Byron Green No lone wolves

whether to invest with an institution or with a small firm should be examined on a case by case basis. Institutions have excellent managers such as Edwin Schultz at Coronation and Gail Daniel at Investec but also strong independents —

Heiko van Wyngaarden at Oryx and Patrice Moyal at Visio — would be examples of this.

TriAlpha's Van Wyk says that the funds of hedge funds, and the incubation funds which they run, will play an even more

important role as the gatekeepers for new funds — as they provide three things they need, capital, infrastructure and fast-tracked regulatory approval.

Just so long as bureaucracy and entrepreneurial flair can live side by side. ■

The master chefs

Like unit trusts, past performance should not be the only consideration when choosing hedge funds.

But there are undoubtedly funds which have shown enough consistency of performance to be considered quality managers — even displaying skill, that most elusive of qualities.

We asked Simon Peile, who picks hedge funds at Sygnia Asset Management to help us choose three funds, with entirely different mandates and investment styles, that can be considered the blue chips of their sector.

In the long/short equity category, Oryx SA, run by Heiko van Wyngaarden is unusual for a hedge fund as it has the all share index as a benchmark. And it has proved to be one of the rare “have your cake and eat it” funds.

It has kept up with the all share index in the good years — for example, it was 45.2% up in 2006. But in a bad year such as 2008, with the all share down 25.7% it was still up 1%.

The fund invests primarily in SA equities, and at times it has been up to 30% net short but it also invests up to 10% of its capital into international corporate bonds.

Van Wyngaarden describes the 1% return as disappointing. He certainly proved that even the highest flying managers can make mistakes.

Unlike most long/short managers he has been prepared to go net short — or bet against the market in aggregate.

But in October and November 2008 he believed the JSE was looking cheap — which was quite a rational view, and he took a hefty net long position.

And he suffered from the further

collapse, losing about 4.5% during those two months.

Not the kind of returns that would sink the *Mayflower* but upsetting for a perfectionist like Van Wyngaarden.

A lower adrenaline ride is provided by Andre Malan's Fairtree. The term market neutral is abused by fund promoters, but this fund is close to being the real thing. It rarely has a net exposure above 10%, so its short positions are almost always offset by longs. In the classic tradition of Alfred Winslow Jones

the founder of hedge funds, it focuses as much as it can on pair trades — for example it might go long Foschini and short Truworths. It has a highly disciplined stop loss strategy, liquidating positions after a certain level of loss has been suffered. The returns from this fund are extremely solid and in 2008 the return was a stellar 19.6%. There was some stress in the winter when there were three consecutive months of losses, but even these amounted to just 1%.

Peile also has a high regard for the Coronation Multi-Strategy Arbitrage Fund run by Edwin Schultz.

This is another market neutral fund to the naked eye, and it operates in the equity field not in the more esoteric world of statistical arbitrage. But Schultz says it still pursues arbitrage themes such as NAV arbitrage, when the price of a share and its pyramid are out of line as well as merger arbitrage — perhaps on the forthcoming Tiger/AVI actions.

The fund has consistently provided returns ranging from 12%-17%, usually meeting its target of cash plus 5%. ■



Simon Peile Solid pedigrees