

# A challenge

## Striking a balance between better returns and higher risk

**Absolute return funds** is a highly subjective category of funds. Ultimately all retail and institutional investors need their money and no funds set out to destroy their clients' buying power in real terms. The traditional balanced fund — with about two thirds of its investments in growth assets such as equity and property and a third in fixed income — has proven to be an effective hedge against inflation, achieving an average 5% real return.

But that is no compensation for members of defined contribution pension funds who retire just after a market crash. Historically, the best way to pre-

**WHAT IT MEANS**  
The global financial crisis proved to be one of the true tests of absolute funds

vent this was to move the member into a money market fund a year before retirement, or perhaps to

put him or her into a low-equity fund five years before.

In most of the world the term absolute return fund means a hedge fund.

But while hedge funds aim to provide positive returns every year, pension funds are allowed to invest only 10% of their assets into them. But in SA the term is used for multi-asset funds that are targeted against inflation and not against the peer group.

Alexander Forbes has a dedicated survey for absolute return funds, ranking them according to their inflation targets. The most conservative aim for inflation plus 3% and they go up to inflation plus 7%. The higher the target, the higher the reliance on equity and property.

Henry Munzara, head of absolute return funds at Stanlib, says that the default allocation for its inflation plus 3%

fund is 20% in equity, 55% in fixed interest, 15% in property and a further 10% in off-shore assets. For the CPI plus 5% fund it is 40% equity, 10% property, 10% off-shore and 40% fixed income.

Both funds aim to have no losses over a rolling 12-month period.

One of the true tests of whether a fund is genuinely an absolute fund is its performance in 2008, the year of the global financial crisis.

In the inflation plus 5% category Foord Absolute lost 7,6% and Metropolitan Absolute 2,7%. There was an 11,3% loss in the unfortunately named RMB Prominent Inflation Fund and a 3,9% loss from Investec Opportunity.

These are not necessarily bad funds, but rather funds with too much focus on equities. Munzara says he increased exposure to equity and property over the past three years. "Our capital preservation strategy was working well. In 2008 Stanlib Absolute



"Our capital preservation strategy was working well ... but it was tougher to beat inflation without more growth assets" — HENRY MUNZARA

**ABSOLUTE RETURN MANAGER WATCH™ SURVEY**  
**INVESTMENT DATA TO THE END OF MARCH 2011**

## Performance Data

	Portfolio inception date	1 Year (%)		3 Years (%)		5 Years (%)		Calendar year (%)			Portfolio size	
		Portfolio	Benchmark	Portfolio	Benchmark	Portfolio	Benchmark	2010	2009	2008	Size (\$m)	Rank
<b>HEADLINE CPI +3%</b>												
Absa Inflation Beater Fund	Oct '02	8,55	6,72	*	*	*	*	10,29	10,48	*	480,97	24
Cadiz Capital Preservation Fund	Mar '97	7,30	6,72	10,05	9,29	9,84	9,87	9,04	12,28	9,15	1 242,5	15
Cadiz Inflation Plus 3	Oct '06	11,82	6,72	*	*	*	*	15,08	*	*	294,2	29
Coronation Inflation Plus Fund I	Oct '09	13,49	7,22	*	*	*	*	15,95	*	*	346,0	27
SIM Absolute	Dec '01	11,75	6,72	10,78	9,29	10,10	9,87	13,51	13,17	4,02	379,4	26
SIM Absolute Return Income Fund	May '04	9,07	6,72	*	*	*	*	10,72	8,51	*	4 663,0	6
Prudent Positive Ret Med Aid Fund #	May '02	8,18	6,72	11,23	9,49	12,83	9,75	8,95	12,86	13,28	865,4	19
Taquanta Absolute #	Jun '01	9,39	6,72	11,38	9,49	10,56	9,75	10,13	12,79	11,95	1 443,6	13
Vunani Fund Managers CPI +3 #	Mar '05	8,42	6,72	8,18	9,49	8,35	9,75	11,23	11,58	0,64	455,6	25
<b>HEADLINE CPI +4%</b>												
Absa Absolute Return Fund	Dec '06	10,16	7,72	11,27	10,29	*	*	12,72	12,04	*	4 454,6	7
Investment Solutions Stable Focus	Apr '05	8,59	7,72	11,42	10,29	11,23	10,87	10,50	13,51	11,04	1 367,4	14
Omigsa Capital Builder	Mar '08	5,89	7,72	7,30	10,29	*	*	6,31	12,15	*	1 096,4	16
Stanlib Medical Investment Fund	May '06	5,53	7,72	6,15	10,29	*	*	8,18	11,47	1,03	264,4	30
Argon Absolute Return #	Oct '06	6,89	7,72	6,08	10,49	*	*	10,32	10,25	*	548,8	21
<b>HEADLINE CPI +5%</b>												
Foord Absolute	Dec '00	11,07	8,72	7,66	11,29	11,65	11,87	15,44	18,18	-7,57	154,9	33
Invest Solutions Real Ret Focus Local	Oct '02	10,53	*	11,80	*	11,61	*	13,81	16,09	3,92	9 024,2	3
Invest Sol Real Ret Focus Portfolio	May '03	8,71	*	8,95	*	10,53	*	10,76	12,99	3,05	3 917,4	9
Metropolitan Absolute	Dec '01	9,84	8,72	4,18	11,29	7,46	11,87	11,54	4,22	-2,70	248,6	31
Prudential Global Inflation Plus 5%	Dec '02	11,47	8,72	*	*	*	*	13,18	12,12	*	4 177,1	8
SIM CPI +5%	Dec '03	9,67	8,72	8,24	11,29	9,02	11,87	10,04	10,99	2,76	5 139,4	5
SIM CPI +5%	Jan '07	11,95	8,72	10,70	11,29	*	*	14,12	15,30	*	2 487,5	11
Stanlib AM Absolute	Jul '01	6,29	8,72	4,57	11,29	7,79	11,87	7,58	7,40	1,10	9 400,9	2
Stanlib Domestic Absolute Return	Mar '04	5,87	8,72	5,38	11,29	8,22	11,87	7,96	10,66	-1,28	327,0	28
Mergence Absolute +5% Fund	Jul '06	6,66	8,72	7,81	11,29	*	*	9,37	12,79	-0,22	3 619,4	10
SMM Absolute Return	May '03	10,93	8,72	*	*	*	*	13,44	*	*	521,1	23
Cadiz Inflation +5% #	Feb '06	15,33	8,72	13,43	11,49	*	*	19,70	18,84	2,96	170,0	32
Coronation Absolute #	Jan '04	16,05	8,72	15,93	11,49	14,93	11,75	21,54	22,94	-0,20	8 763,1	4
Investec Absolute Balanced #	Jan '03	7,47	8,72	9,88	11,49	9,71	11,75	7,67	11,44	11,63	1 962,8	12
JM Busha Absolute All Class #	Oct '06	11,58	8,72	8,07	11,49	10,09	11,75	14,48	14,75	-3,38	540,7	22
Prudent Positive Return Fund* #	Jan '99	7,14	8,72	10,04	11,49	11,49	11,75	8,18	11,83	12,22	28 073,6	1
RMBAM Prominent Inflation #	Nov '03	9,88	8,72	7,38	11,49	7,38	11,75	13,4	15,11	-11,34	1 060,5	18
SYMMETRY CPI +5% Fund #	Sep '02	9,20	8,72	8,20	11,49	9,48	11,75	10,71	10,75	2,59	1 065,9	17
Vunani Fund Managers CPI +5 #	Mar '05	10,59	8,72	8,82	11,49	8,76	11,75	15,04	13,82	-3,29	775,1	20

## Market Statistics

Combination of old CPIX & new CPI*	3,72	6,49	6,75	
Consumer Price Inff (Old/new comb CPI)*	3,72	6,29	6,87	
Consumer Price Inff (Headline CPI)	3,72	5,99	6,34	
STFI	6,54	8,81	8,82	
Number of participants	33	27	20	
Total fund size of participants				99 331,5

# Funds benchmarked against CPIX + objective prior to Jan 2009. 1 — Coronation Inflation Plus Fund has a benchmark of CPI +3,5%. \*\* This implies that the Sortino Ratio will not hold as the fund has not exhibited any negative returns. Inflation figures lagged by one month.

<b>HEADLINE CPI +6%</b>												
Cadiz Equity Ladder Fund	Aug '01	8,85	9,72	*	*	*	*	8,50	42,63	17,52	1 715,0	3
Omigsa Absolute Return Invest	Mar '02	9,86	9,72	10,10	12,29	8,94	12,87	11,30	18,45	-0,72	189,8	9
Prudential Domestic Inflation +6%	Dec '02	14,21	9,72	12,14	12,29	12,63	12,87	18,03	17,19	2,21	620,5	7
Prudential Global Inflation +6%	Dec '02	11,80	9,72	9,63	12,29	10,76	12,87	13,59	12,45	2,62	199,5	8
SIM CPI +6%	Jan '07	11,08	9,72	8,90	12,29	9,64	12,87	11,67	13,53	0,75	32,1	10
SIM CPI +6%	Jan '03	13,03	9,72	11,38	12,29	*	*	15,52	17,89	*	674,9	6
<b>HEADLINE CPI +7%</b>												
Coronation Absolute #	Aug '99	12,95	10,72	12,99	13,49	13,53	13,75	17,45	20,15	-0,94	3 441,6	2
Investec Opportunity #	Aug '99	10,69	10,72	9,65	13,49	12,14	13,75	12,94	21,84	-3,95	19 593,6	1
Prudential Domestic Inff +7% #	Jan '07	14,49	10,72	11,17	13,49	13,05	13,75	19,66	19,20	-3,23	792,8	5
SYMMETRY CPI +7% Fund #	Apr '04	11,52	10,72	9,18	13,49	*	*	14,25	14,66	*	1 663,8	4

## Market Statistics

Combination of old CPIX & new CPI*	3,72	6,49	6,75	
Consumer Price Inff (Old/new comb CPI)*	3,72	6,29	6,87	
Consumer Price Inff (Headline CPI)	3,72	5,99	6,34	
Consumer Price Inff ex OER	3,71	5,83	6,62	
STFI	6,54	8,81	8,82	
Number of participants	10	9	7	
Total fund size of participants				28 924

# Funds benchmarked against CPIX + objective prior to Jan 2009. Inflation figures lagged by one month. \*\* This implies that the Sortino Ratio will not hold as the fund has not exhibited any negative returns.

Reasonable use of the survey may be made for purposes of comment and study provided that full acknowledgment is made to "Alexander Forbes Asset Consultants".

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## Asset Management

# The opportunities associated with hedge funds

By Kent Clark, Managing Director, Alternative Investments & Manager Selection  
(AIMS) Group, Goldman Sachs Asset Management (GSAM).

By accessing unique investment opportunities and providing diversification through lower correlation to broader markets, in our view hedge funds have a unique and important role to play in many portfolios. In short, we believe hedge funds can make your money work harder.



The philosophy of hedge fund investing revolves primarily around the skill of the manager, rather than the return of the market. Representing a wide variety of manager expertise, hedge funds are not a homogeneous group and invest using many different strategies, each with differing performance profiles. Hedge fund managers are free of many of the constraints that traditional asset managers operate under, allowing them to borrow money to invest, sell securities short and use instruments such as derivatives to express views and manage risk. Investments across the full range of asset classes are considered, including equity, interest rates, FX, credit and commodities.

However, the variety of ways in which hedge fund managers generate returns can make building and managing a robust hedge fund portfolio challenging. Sourcing high-quality managers requires an extensive global network, and the large dispersion in manager performance means that selecting the best managers is essential. Extensive due diligence, both on the investment strategy and on the operational setup, is required, but can be resource intensive and requires unique capabilities to evaluate what can often be complex investment platforms.

The hedge fund industry is responding to investors' preferences for increased transparency and liquidity, and hedge fund strategies continue to adapt to market changes. How is your portfolio positioned for the future?

As investors seek different ways to generate alpha and diversify risk, Goldman Sachs Asset Management (GSAM) has developed innovative investment solutions designed to meet these needs. We offer the flexibility, skill and resources to meet our clients' diverse objectives. GSAM has fostered creativity in investment strategies since its inception in 1988 and we are now pleased to manage US\$89bn<sup>1</sup> in alternative assets for our clients.

## GSAM wins Professional Pensions 'Alternatives Manager of the Year Award'.

Furthermore we are pleased that our innovation and expertise in alternatives and particularly hedge funds has been recognised by the industry. On the 5th May 2011 GSAM was awarded the "Alternatives Manager of the Year" at the Professional Pensions UK Pension Awards in London. These awards are one of the most prestigious in the UK Institutional Industry. The judges commented on the strength of our hedge funds platform and the market-leading diversity and breadth of solutions we offer to our clients.

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<sup>1</sup> AUM as at 31 March 2011.



Errol Shear

The best performing absolute return fund over the past three years has been Coronation Absolute, with a 15,9% annualised return. It is comanaged by Louis Stassen, who started the first absolute return fund in SA, and Henk Groenewald. It is a fund for people with at least some tolerance for losses. It aims not to lose money — but only over periods of 36 months or more. Stassen encourages investors to come into the fund for at least five years.

About a quarter of the equity portfolio, which makes up 58% of the fund, is hedged through put options. And it anticipated the sell-off of bonds in the first quarter by reducing its bond holdings to 13%, with most of the portfolio in bonds with a duration of four years or less. It shares many of its stock picks with the Coronation house-

view portfolios, both increased exposure to the banks, and took advantage of a slump in the Aspen share price to bring it into the portfolio.

The close cousin of the absolute return fund is the real income fund. This is a useful product for people who are already retired and are drawing income from a living annuity. Atlantic Real Income, for example, provided a 10% return last year, which might look dull until it is compared with the 6%-6,6% generated by money market funds. Atlantic chief investment officer Arno Lawrenz says the intention of the fund is to ensure that clients can grow their income ahead of inflation. "There is no doubt that inflation linked bonds are very useful in helping to deliver this solution, though with a real yield of just 2,5% there might be more efficient ways to achieve the fund's goals. For example, when money markets are yielding 12%-13% and inflation is 8% and falling, cash is a better option," he says.

Lawrenz says that even though Atlantic is a focused fixed interest house it provides for up to 25% of the fund to be invested in equity and another 10% in property. "We are not trying to be better stockpickers than Allan Gray or Coronation, but there is a high correlation between certain equities and drivers of inflation — the simplest example is the link between the oil price and the Sasol share price," he says. ■

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HEDGE FUNDS

# New stamp of approval

For most pension funds there has been little incentive to even put hedge funds on the agenda at investment committee meetings. Under the old regulation 28 of the Pension Funds Act, they were confined to 2.5% of fund assets — if they were sold through a debenture structure, their share could go up to 5%.

The industry is also quite small and niched. The oldest fund in the Symmetry hedge fund survey, the market-neutral Big Rock Fund, was started in January 1999. It is a small industry with R30bn under management. This could increase significantly now that regulation 28 has been amended to allow up to 10% of fund assets to be placed in hedge funds.

Tony Bell, head of multi-asset funds at Vunani, and one of SA's most experienced absolute return managers, says that trustees must be careful.

"The ability to sell shares short is described as a double alpha strategy, but it is also a double risk strategy. If the

shorted shares go up and the long shares go down, the fund is hit on both sides," he says.

Bell says trustees need to be clear about what hedge funds will add to the risk and return characteristics of the fund. They are supposed to provide uncorrelated returns. But the vast majority of hedge funds in SA have equity centred strategies. The long/short funds will almost always benefit from a rising market as they are structurally biased towards one. Some have shown a peak to trough loss (in industry jargon a maximum drawdown) of more than 20%: the worst, Cogito Alpha with 38.6%.

Other funds with poor capital protection are Praesidium SA Hedge Fund, down 25.8%, Catalyst Variable Bias (minus 25%) and Florin Impact Fund down 24.7%.

The market-neutral funds have been better at preserving capital with a couple of exceptions that probably have not been correctly classified — the Investec Active Quants Fund had a 20.2% loss and PSG Double Diamond 15.7%.

Market-neutral funds also provide low volatility, and while it should not matter whether it was a bumpy road or a smooth road — what matters is the amount on the cheque when you exit the fund — there is a sleep-at-night factor. Long-only equity

"The ability to sell shares short is described as a double alpha strategy, but it is also a double risk strategy"

— TONY BELL

funds typically have volatility of about 25%, long/short funds 7.5%, but market-neutral funds have volatility on average below 3%.

Fixed income funds might also have a part to play in a pension fund's line-up of assets. As it is a highly liquid tradable sector, there are lots of opportunities for investors playing the yield curve and taking numerous bets on forward rate agreements.

In the past the returns from the sector tended to be rather pedestrian, not that different from a well-run long-only flexible income fund. A low-profile manager in Fourways, KADD, has proven to be an exception. Its Validus Fixed Income Fund has produced a 22.6% return over the past three years, well ahead of competitors.

It had a very strong year in 2009 with a 37.3% return as it benefited from the unexpectedly high number of interest rate cuts by the Reserve Bank.

Bruce Simpson, manager of the Gen-X Fixed Income Arbitrage Fund, says that it is important for investors to know what they are buying.

"The process in our fund is designed to give a more consistent series of returns. It is analogous to the difference between a market-neutral fund and one of the more aggressive long/short equity funds," he says.

As it happens, over the past 12 months Gen-X has given a 13% return (in line with what it has given year-in and year-out so far), while KADD's returns are down to 8.7%, admittedly still quite a respectable outcome. ■

Special Report written by Stephen Cranston  
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Bruce Simpson