



## **SAKE24 ALTERNATIVE INVESTMENTS**

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### **FUNDS OF HEDGE FUNDS SET HIGH STANDARDS FOR MANAGERS**

Funds of hedge funds optimise the advantages of hedge funds by giving investors diversification benefits, reduced risk and access to the best brains in the business – all for the same amount of capital generally required to invest in a single fund.

According to Carla de Waal, Portfolio Manager at Novare Investments and member of the Mayibentsha Fund of Hedge Funds team: “As the core investor group allocating money to local hedge funds, funds of hedge funds have been important drivers of the South African industry, providing an interface between individual managers and end investors.”

De Waal said it was important to select managers with strong processes, and given the commitment required to scrutinise the 150-plus hedge funds available in South Africa, investors benefit from considerable savings by investing through a fund of hedge funds.

These funds have also been instrumental in setting industry reporting and governance standards.

Said de Waal: “One of the value-adding propositions of a fund of hedge funds is ongoing oversight of the underlying funds and the risks they are taking. To do this, and to track how risks in underlying portfolios are offset - with a view to maximising the benefits of diversification - funds of funds require a high standard of reporting by their managers. This includes regular performance updates and portfolio holdings transparency, all of which place funds of funds in an excellent position to measure and mitigate risk.”

In this regard, the regulatory standards for funds of hedge funds, recently published by the International Organisation of Securities Commissions (IOSCO), aim at dealing with investor

protection issues that arose with the increased involvement of retail investors in hedge funds through funds of hedge funds. In particular, the standards address the methods by which hedge fund managers deal with liquidity risk, and the nature and conditions of the due diligence process used by funds of hedge funds managers.

Said de Waal: "It's reassuring that, from a Novare perspective, we have already implemented the best practice recommendations of the IOSCO. Liquidity in our funds is managed to ensure we're always in a position to meet client redemption requests, while also being cognisant of the legal and regulatory requirements with which our clients, including pension funds, are required to comply.

"We comply with all of the IOSCO's recommendations on due diligence, which we conduct in-house in the belief that significant value is added through a close understanding of our underlying managers and their portfolios."

Hedge funds of funds also conduct due diligence checks on service providers to hedge funds, including prime brokers and administrators.

Funds of funds need to ensure that the mandate given to hedge fund managers suits the clients' risk and return objectives, and that managers stick to their mandates. This requires continuous monitoring of underlying investments.

"As a fund of funds it's important to have a clear understanding of how managers are positioning their portfolios. So we analyse how different strategies are likely to perform under different market conditions in order to choose the best managers for a particular strategy. We go to some length to ensure that investments in underlying hedge funds don't introduce operational or business risk to our portfolios," said de Waal.

"In terms of economies of scale, many hedge funds have high minimum investment requirements. For the same amount that an individual can invest in one hedge fund, an investment in a fund of funds offers a much wider spread."

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