



## **NEWS RELEASE**

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### **ALIGNMENT WITH INVESTOR INTERESTS WILL DRIVE HEDGE FUND GROWTH**

In South Africa the business and investment case for hedge funds remains solid, with growth in the future likely to be driven by product development and legislative change affecting the way retirement funds can invest.

That's according to Carla de Waal, portfolio manager at Novare Investments. "Globally, hedge funds face the challenge of greater regulatory scrutiny, with the focus on manager regulation. Locally we've already embraced that. Also, South African funds of hedge funds have been proactive in implementing best practices and will continue to play a big role in a changing regulatory landscape."

The performance of SA hedge funds held up well during the financial crisis.

"Not only over the past two years, but more importantly, over the longer run, local hedge funds have showcased significant value-adding benefits in terms of better risk-adjusted performance and reduced downside risk in investor portfolios," said de Waal.

Speaking from the perspective of a fund of hedge funds manager, she added that despite relatively good investment performance, the local industry had not attracted fresh inflows over the past year with assets under management steady at around R30 billion. This is in contrast with global hedge funds, which saw net inflows turn positive in the third quarter of 2009. According to Hedge Fund Research Inc, global hedge funds experienced their largest quarterly inflow in the fourth quarter of 2009 since the first quarter of 2008.

Locally, pension funds remain heavily under-invested with the Alternative Investment Management Association (AIMA SA) estimating an average exposure to alternative investments of just 1.3% compared with the global average of 18%.

Said de Waal: "Local pension funds need to have a larger exposure than this if they are to fully benefit from funds designed to protect against market downside. Even though hedge fund managers in South Africa are regulated, the lack of a regulated product to house bi-directional funds in the pension fund

arena has limited the scope of investment from these investors.

“The biggest challenge for local hedge funds and funds of funds is certainly to attract inflows and more investors. Besides the challenge of achieving greater regulatory certainty in the product space, there is a need to revisit whether the industry currently offers the right type of products and what risk profile it should target.

“Foreign investors are seemingly looking for far riskier products from emerging market managers, whereas the local hedge fund industry has been very conservatively positioned with products focused on downside protection – that is, cushioning client portfolios like pension funds against severe market drawdowns similar to those experienced during 2008.”

De Waal said liquidity would be a focus point for investors in future, especially as some struggled in 2008 to exit funds that followed less liquid strategies.

“In most cases redemption provisions such as gating or exit penalties are designed to protect investors staying in the fund,” said De Waal. “However, the consequences for the industry are more widespread as the underlying problem is most often a mismatch between the liquidity profile of the holdings in a portfolio, and the redemption terms offered to investors.

“Products need to be designed for better alignment, and risk managers need to improve their monitoring of the impact of market events on portfolio liquidity. Given the liquidity preferences of certain investors, some hedge fund strategies will be unsuitable for certain clients, despite an attractive returns profile.”

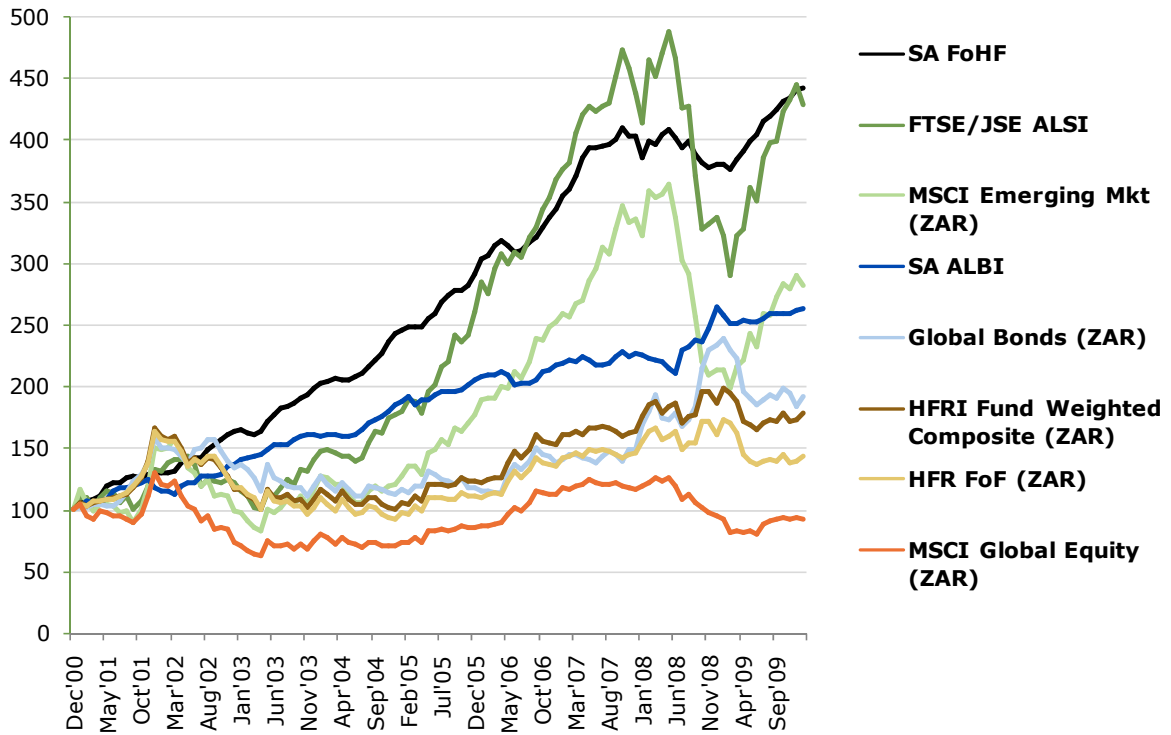
According to de Waal, sustainable growth in the industry is possible if managers can better match their product offering with investor expectations. This is also the challenge for intermediaries such as consultants who advise end clients.

“The local hedge fund industry has already gone the extra mile in terms of best practices including independent service providers, disclosure and transparency. But we need to see more innovative product solutions to broaden the spectrum for funds of funds to choose from.”

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Illustration: Hedge funds: The SA experience

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Source: I-Net Bridge, [www.hedgefundresearch.com](http://www.hedgefundresearch.com)