



MEDIA RELEASE

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INVESTOR REDEMPTIONS LEAVE SOME HEDGE FUNDS AT RISK

This will be a watershed year for the hedge fund industry as managers face the kind of market conditions that separate luck from alpha-adding skill.

That's the view of Carla de Waal, Portfolio Manager at Novare Investments who says that the South African hedge fund industry survived 2008, a year of unprecedented headwinds, in relatively good shape. Overall, most domestic hedge funds managed to preserve capital, especially in the second half when the local equity market reported double digit losses.

Market neutral and fixed income strategies managed to post strong returns for the year, in the majority of cases beating cash. However, many funds also had to deal with significant outflows as investors sought liquidity amidst the growing credit crisis.

According to de Waal: "Last year turned out to be a roller coaster ride for most hedge funds as the global macro environment changed abruptly. Coming through a five-year domestic equity bull market, most long/short hedge funds were caught with a net over-exposure to shares going into the year – with dire consequences as markets sold off aggressively.

"However, as volatility reached record levels hedge funds moved quickly to reposition themselves by aggressively reducing both leverage and their net exposures."

Funds that failed to reposition themselves quickly enough and those with too much exposure to less liquid counters like small cap stocks, suffered draw downs.

A considerable number of funds also failed to beat their benchmarks in 2008, which means that under-performance will need to be made up before these funds again start earning performance fees.

“This does increase the business risk for investors in these funds, as smaller managers especially may find themselves with insufficient assets to maintain business stability. While there may be some casualties following investor redemptions, industry consolidation is not necessarily a bad thing as the larger surviving hedge fund houses will be better equipped to deal with regulatory changes and to serve institutional investors,” de Waal said.

For local hedge funds the market performance battle last year was fought alongside changes on the regulatory front that shifted the focus towards operational issues. For the first time, hedge fund managers had to apply for a “special category” Financial Services Provider licence from the Financial Services Board (FSB).

This against the global background of headline-making stories like those on the Madoff fraud, which prompted customers of the industry to revisit their due diligence processes and other operational checks.

De Waal says another challenge is to deal with the many misperceptions investors and potential investors have about hedge funds. “There’s a need to address investor concerns, and to highlight the facts about the industry, as opposed to the hype.”

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Notes to Editors:

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