



MEDIA RELEASE

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SOUTH AFRICAN HEDGE FUNDS HOLD THEIR OWN

As their counterparts in the UK and US come under pressure from falling returns that are driving down assets under management, South Africa's R30 billion hedge fund industry seems to be holding its own.

According to Carla de Waal, Portfolio Manager at Novare Investments: "Such are the pressures in the US and UK industries that market commentators increasingly talk about consolidation. As funds under management fall on the back of poor performance and client redemptions, the chances increase that firms will be forced to merge to ensure their continued viability."

Besides falling returns placing fees and profitability under pressure, the sudden withdrawal of client money invested in illiquid longer-term assets may require longer lock-up periods. This will introduce greater inflexibility for which hedge fund investors will expect to be compensated through further fee reductions.

Internationally there is also the impact of the prohibition on naked short-selling currently under review by securities regulators aiming to restore equilibrium to fragile financial systems.

Says de Waal: "Given that US stocks continued to swing wildly, it is questionable whether the temporary ban has worked. In fact, some argue that the on-going sell-off of financial stocks proved that short-selling was not to blame for the crisis. Rather, short-selling is a legitimate investment strategy that helps keep markets liquid and stock prices balanced."

Despite the view that short-selling constitutes an integral part of a healthy market, it seems likely that the ban will be replaced by rules requiring large short-sellers to disclose their trades. Short-sellers arrange to borrow shares they consider overvalued and then sell them. If the price drops, they repurchase shares, return the borrowed shares and pocket the profit.

“The main factor differentiating South Africa from the UK and US in this regard is that the JSE has never allowed naked short-selling. However, the biggest issue likely to impact on the future of hedge funds both here and abroad is the rate at which funds under management grow or decline,” said de Waal.

In the UK, Investment Management Association (IMA) figures show that assets under management across the hedge funds industry fell to £380 billion in the third quarter, from £426 billion in the previous three months – a trend is expected to drive structural change.

Even though South African hedge funds have continued to perform better than their offshore counterparts in the recent market turmoil, the industry has witnessed some outflows. Most of these have been on the back of pension funds, mostly invested via funds of funds, rebalancing their portfolios to comply with regulatory limits.

On average, local hedge funds are down less than 3% over the third quarter (in comparison with the FTSE/JSE All Share Index losing more than 20%), but investors have witnessed a wide dispersion in the returns produced by different funds and between different strategies.

Novare estimates that industry assets under management have shrunk about 7% from July to September.

Francois Cilliers, Portfolio Manager at Novare Investments, commented that while the industry “would have liked to see better returns this year, there is growing recognition that the South African hedge fund industry has performed admirably under turbulent market conditions”.

According to Cilliers there may be some short-term outflows from the local hedge funds, but these are likely to be small compared to international trends. “Given expectations for declining earnings growth prospects in developed markets, the investment case for developing markets looks increasingly attractive over the medium term. International investors are likely to seek domestic expertise to tap those opportunities and South Africa should be a substantial benefactor in helping to allocate capital within Africa”.

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Notes to Editors:

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