

FUND MANAGEMENT

## INVESTMENT LEADERSHIP

## HEDGE FUNDS

## Not quite elite returns

The proposed changes to regulation 28 of the Pension Funds Act were a disappointment to the hedge fund business. There was no explicit reference to hedge funds at all. But there is a demand from the authorities to look at a fund's asset allocation on a look-through basis — many, through life policies, have access to offshore hedge funds, for example. And this will be permitted only if it falls within the 2,5% reserved for funds to put in "other investments" — a category that also includes a large portion of the socially responsible investments in which funds are under pressure to invest.

Has hedge fund investing been worthwhile? Globally, in the decade up to 2010 the S&P 500, the proxy for the American market, was flat. In that context, returns that look anaemic by SA standards would have helped US pension funds declare positive returns to their members.

According to the authoritative Edhec Risk Institute in France, the best category was emerging markets hedge funds, with a 12,6% annualised return — though with a much higher standard deviation, of 10,7%, than hedge funds are supposed to provide. The second-best performer was distressed securities with 11,4%, but these are niche strategies.

Equity Market Neutral follows the original hedge fund process set up by Alfred Winslow Jones more than 70 years ago. Ideally, it has an equal number of long and short positions. These funds have produced a return of 4,8%/year, which in the US at least is higher than cash.

ACPI TriAlpha head of research Sean Curry says that the hedge fund industry has emerged from the global crisis of 2008. Initial expectations of further contractions in 2009 never materialised and in a recent survey Goldman Sachs — if you can trust them these days — says that the global hedge fund promoters are expecting 15% growth this year.

But Curry says that Market Neutral, Fixed Income Arbitrage and Convertible Arbitrage, which often use high leverage to invest in illiquid assets, are out of favour. In contrast, strategies with a liquid

trading bias such as Hedged Equities and Global Macro have become more popular. It is not possible for SA managers to run a conventional global macro fund, even though there are a number of exchange traded funds specialising in currencies and commodities. "That is all very well," says Stephen Brierley, head of the Symmetry Fund of hedge funds. "But we don't have the huge databases that managers use overseas. And there isn't enough mergers & acquisition activity to justify setting up a merger arbitrage fund," he says.

SA hedge funds did not disappoint as much as the global funds in 2008. The shock waves in the two big hubs — Mayfair, London, and Greenwich, Connecticut — were much more acute than those in Claremont and Illovo, SA's two big hedge fund hubs.

But there is still disillusionment about the performance of local hedge funds. Nexis Capital head Kevin Shames was an early promoter of hedge funds, from the days when he set up Mercury Alpha Capital in 1999. However, he is now refocusing his efforts on a flexible long-only unit trust. "It is one thing to protect

capital in falling markets," says Shames, "but hedge funds have the ability to be net short, which means that more of them should be making money in a falling market."

And he says they missed the recent bull market, bearing in mind that hedge funds have the opportunity to go more than 100% long.

Brierley, says there is a definite number of people who are good at the art of short selling. Even good stockpickers can have a prolonged drought. Heiko van Wyngaarden, who manages the R1,5bn Oryx, fund has underperformed for more than a year.

"There is nothing magical about hedge funds," says Brierley. Most institutions opt to invest through a fund of hedge funds. Internationally this made no sense. They have provided 4,4%/year over the past 10 years — several funds of funds were big backers of the Bernie Madoff Ponzi scheme.

SA funds do not have a 10-year history. Over three years, the average fund of hedge funds has given a 6,6% return compared with 9,9% for cash. Can anyone be surprised that SA hedge funds aren't lighting any fires? ■

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