

Dire need for offshore hedge fund training

'We believe it's the only way to assist people wishing to learn about the industry'

I T'S PATENTLY CLEAR that it would be absurd for pension fund trustees, high net worth individuals and others to engage in funds of hedge funds or mere hedge funds without knowing what they're doing. Yet while the hedge fund industry is one of the fastest growing worldwide there's an enormous disconnect between it and public education on the subject.

Significantly, leading fund of hedge funds (FoHF) company Octane has made a major commitment to closing the gap in South Africa by engaging broadly with retirement fund trustees, financial advisers, investment consultants and brokers. Round table workshops were held recently near Johannesburg and in Franschhoek. Bridgette Coombes, of Octane Client Services, says: "More workshops are planned for the near future, both up in Johannesburg and in Cape Town."

Says senior Octane executive Albert Louw: "These aren't marketing exercises – on the contrary.

"Very little, if any reference is made to Octane. We sit down with different groups at different levels, each attendee is given a

Useful pointers for the layman...

THE FOLLOWING pointers arose at a recent round table workshop near Johannesburg and certainly provide some useful grounding for pension fund trustees and others trying to find their feet.

Speakers from the Octane team in SA included executives pan-African region MD Duncan Theron, institutional business head Albert Louw and global reporting head Greg Theron, plus Telkom's Hurrell.

Hedge funds have been around since 1949 and invest in almost any opportunity in any regulated market. That may sound too broad, but that's precisely what a hedge fund is. Their managers have access to a broader set of "tools" than traditional investment managers.

The hedge fund industry comprises a wide range of alternative strategies, all of which are collectively labelled as "hedge funds". No wonder that the term "hedge" creates confusion, especially given the popular misconception that all hedge funds protect investors' capital during short-term market fluctuations.

In fact, only one or two "less directional" hedge fund strategies aren't correlated to offshore equity and bond market returns and aim to protect "hedge" investors' assets over shorter time horizons.

Over the longer term offshore hedge funds have shown they can protect capital while still producing returns in excess of offshore cash and bonds.

Active offshore hedge fund

options available to investors: They have the choice of investing via a single hedge fund manager, FoHF or a unique option whereby the investor selects a FoHF model where the hedge fund manager constructs a client specific portfolio by combining a number of FoHFs into a client-driven solution.

That FoHF approach provides the added value of manager selection, portfolio construction and portfolio and risk monitoring.

Selecting a fund of hedge fund manager in an ever-growing sector: The sector currently comprises more than 2 300 FoHFs. It's therefore important for investors to follow a proper initial screening process to reduce the aforementioned list to a more manageable one. The liability profile of the investor, performance target, drawdown limits, volatility ranges, among others, could be used as filtering tools. Other items – such as the fund's track record and size – may also be considered. Much attention has been given to previous size of a fund, as research provides ample evidence that size affects performance.

Getting the offshore asset mix right: Investors shouldn't place 100% of their assets in hedge funds despite any traditional quantitative approach indicating an optimal allocation of 100% to hedge funds.

Investors ought also remember that rational investment decisions can't be made by simply looking at historical

numbers.

The allocation process also requires a subjective assessment of issues, such as how liquidity, complexity and transparency impact on optimisation results. Regulation 28 of SA's Pension Fund Act allows investors to invest their full 15% offshore allowance in offshore hedge funds.

Furthermore, trustees should consider at least a 5% allocation to impact the risk: return of the fund and ensure that the allocation matches the liability profile.

Operational and reporting issues: What many investors aren't aware of is that more than 50% of hedge fund failures are due to operational risk and not investment risk.

It's consequently important for investors to have a good overall understanding of how the hedge fund structure works and be equipped to pursue appropriate due diligence exercises.

Future challenges: Surveys conducted by reputable organisations generally concur that the hedge fund industry is poised for further rapid growth.

Major challenges will be getting to grips with increased competition in the industry, hedge fund selection and delivering respectable alpha (outperformance). Institutional investors are imposing traditional processes on hedge funds, which are consequently challenged to ensure that they have appropriate procedures and controls in place. ▣

pack of intellectually based information, various informative presentations are given and then the floor's opened for discussion.

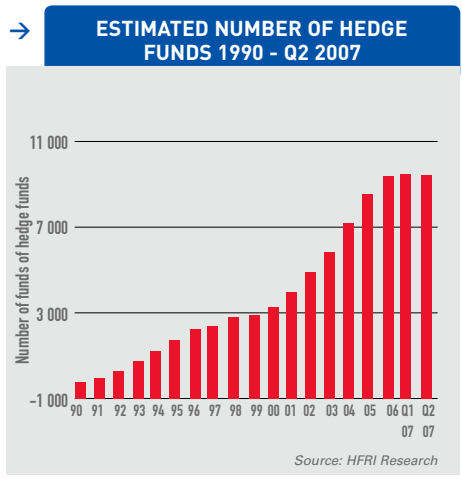
"We believe it's the only way to assist people wishing to learn about the industry."

One attendee, Dennis Hurrell, chairman of the Telkom Retirement Fund investment committee, says no formal trustee training exists involving hedge funds and he's appealed for a formal trustee-training curriculum.

Hurrell says trustees broadly should consider making meaningful financial allocations to address the situation.

"A major difficulty for trustees is that generally they're busy people, they aren't remunerated for their services and often regard their fiduciary duties as an interruption to their normal duties. To legislate for compulsory training, courses or qualifications would be difficult.

"However, that doesn't imply that training isn't required. On the contrary: hedge funds are highly specialised and it's essential for trustees to be educated to empower them in making informed decisions."



There are in excess of 15 distinct investment strategies now used by hedge funds globally and the list continues to grow.

Currently, long-short equity is the most widely used by hedge fund managers.

The hedge fund sector currently comprises approximately 10 000 single hedge funds and more than 2 300 FoHFs. Since 1990 the number of newly estab-

Offshore asset allocation for SA retirement funds

FUND OF HEDGE FUNDS (FOHFS) are increasingly being incorporated into the offshore allocations of South African retirement funds and limited by legislation to a maximum of 15% in terms of their offshore exposure.

That trend is in line with that of international retirement funds, which are now responsible for approximately 50% of all new offshore hedge fund inflows.

That's unsurprising, as academic

in SA," says pan-African MD Duncan Theron. "You can see the need for diversification. You want to be correlated when the markets run but you want hedge fund exposure when they turn. When volatility spikes there's much greater opportunity for hedge funds to maximise performance."

It's Octane's experience that most large SA retirement funds have allocated approximately one-third of their offshore allocation to offshore

When volatility spikes there's much greater opportunity for hedge funds to maximise performance.

studies present ample evidence of the diversification benefits in terms of adding FoHF to the total offshore portfolio mix.

Historically, offshore hedge funds have demonstrated similar volatility characteristics to offshore bonds and lower volatility than offshore equities.

"Look at the past few months

FoHFs. A major difficulty in modelling offshore hedge funds is an absence of long-term performance history, says Theron.

Data only goes back 17 years, making it difficult to project long-term risk and long-term parameters, together with the fact that hedge fund returns are asymmetrical and not normally distributed. ▣

lished single hedge funds and FoHFs has grown in excess of 20%/year, with double-digit growth forecast.

Octane is an independent, specialist alternative FoHF manager founded in

2001.

Its head office is in Frauenfeld, Switzerland, with offices in New York, Johannesburg and Cape Town. Sanlam is a key shareholder. ▣

