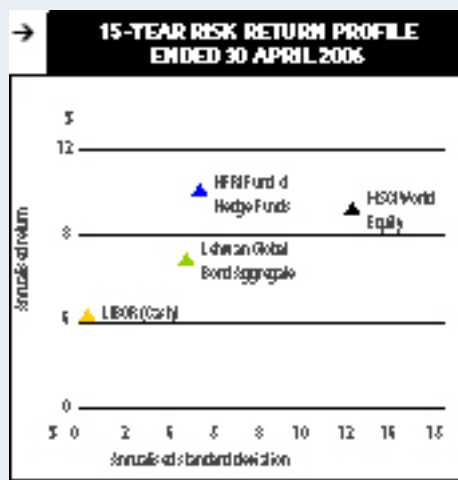


Offshore hedge funds key to a well-diversified portfolio

But choosing the most optimal investment managers is no simple task

Offshore hedge funds, when added to traditional investments, have over the last 15 years resulted in reduced volatility, enhanced returns, better risk adjusted performance profiles and much improved absorption to shock events.



At recent Brains Trust meetings at Octane's head office in Switzerland, investors from all over the globe debated offshore hedge fund issues. Investors all agree that offshore hedge funds form a key part of any well-diversified investment

Octane's phenomenal success has been as a result of its client-focused approach and proven offshore hedge fund manager selection capabilities.

portfolio. The key issue, however, in terms of any offshore hedge fund investment is to find the most optimal investment managers. This is not a simple task.

The universe of offshore single strategy hedge fund managers is in excess of 9 000 managers and the fund of hedge funds universe is in excess of 1 700. Furthermore, the hedge fund industry has grown from US\$25bn in 1990 to almost

\$1 trillion in 2005. How then does an investor select one or two managers out of this large and ever-growing universe?

Investors who have already allocated a portion of their investments to offshore hedge funds have typically selected one or more fund of funds managers to manage their hedge fund assets. A fund of funds manager selects a range of single strategy hedge fund managers and then combines them into a well-diversified portfolio to achieve investors' specific objectives. Fund of funds managers now account for approximately 40% of all hedge fund assets but also the large majority of new inflows.

South African investors have to date typically utilised rather simple screening criteria to dilute the more than 1 700 offshore fund of hedge funds managers to a more manageable universe of fund of fund managers to select from. The process has been to select one or more of these offshore funds of funds managers that have some form of presence in SA.

The rationale for such reasoning is understandable, as most South African investors, even the largest of pension fund investors, feel that they do not have control over their offshore assets if the manager has no presence in SA.



Research proves that size impacts performance adversely. **ROBBIE ALEXANDER, CHIEF EXECUTIVE OFFICER OF OCTANE**

If one follows this approach an investor has typically diluted the entire universe to a small proxy of 10 or so fund of hedge funds, of which the investor then selects one or two.

The problem with this approach is that it is perhaps too simplistic. When analysing these 10 fund of hedge fund managers »

« with some form of SA presence one finds that they are very similar in their approach to targeting similar returns and risk.

These fund of funds managers typically target a return of 5% to 7% and a 3% to 4% risk. Furthermore, the liquidity of the products ranges from 90 to 120 days. Research furthermore shows that these managers' products have typically shown correlation numbers in excess of 0,5 to the world equity markets.

This is not suitable for many investors,

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as their needs are much more sophisticated than a standard off-the-shelf product. For example, if an investor believes that a return of 10% to 12% is required in order to compensate him for the additional risk of investing outside of cash and furthermore requires a lower correlation than 0,5 to the equity markets and also requires 30-day liquidity, how does this investor go about selecting a fund of hedge fund man-

ager? The simple answer is that the investor then has to look beyond only those funds of hedge fund managers that have some form of local presence, but then the investor cannot be expected to be serviced adequately from some distant domicile.

Robbie Alexander (Chief Executive Officer) and Mustafa Zaidi (Chief Investment Officer) founded Octane in 2001 to fulfil the role – ie, to select the best managers across the globe but to provide the investor with a strong SA presence or servicing arm.

To date Octane has constructed various customised, client-orientated risk-profiled fund of hedge funds solutions with assets under management in excess of \$1,2bn.

Alexander says: "The solutions that we have constructed have been top quartile performers since their inception and have shown material alpha relative to their respective benchmarks. Our managers have long-term track records and exceptional people."

In terms of South African clients' offshore hedge fund assets, Alexander notes that Octane now manages assets for five of the largest pension funds in SA. "This can be seen as a vote of confidence in our process and hedge fund manager selection capabilities," he proudly says.

"In terms of our SA presence, Sanlam is a major shareholder in Octane. This provides our business with strong backing plus an additional layer of risk management and compliance requirements, which our parent enforces on us."

Alexander believes that their phenomenal success has been as a result of their client-focused approach and proven hedge fund manager selection capabilities. "Whereas our competitors only select single strategy hedge fund managers, we focus on selecting fund of hedge fund managers but do incorporate single strategy hedge fund managers if the

client solutions require this.

We like smaller niche fund of hedge fund managers, as our research proves that size impacts performance adversely. As a result we would not be interested in selecting any of the fund of hedge fund managers that currently sell their offshore hedge fund investment management services in SA. They're just too big and their performance is average. Although the smaller and more niche managers that Octane selects have no South African presence we fulfil this role for them. Our selected managers just have to focus on generating top risk adjusted performance. They stay absolutely focused. We'll handle the clients."

Duncan Theron, managing director of Octane Pan Africa, notes: "Our staff in SA play a consulting role rather than a marketing role – ie, we work closely with our clients, provide them with technical advice and then define their needs, after which we incorporate our manager research team based in New York to construct the customised solution by selecting and optimising the most suitable managers.

"The South African team is now the largest SA-based team of the entire universe of offshore fund of hedge funds managers and we are looking to appoint more staff within the next few months."

The New York team operates out of the Tri-state area, where the large majority of hedge fund and fund of fund managers operate. During the last 12 months Octane has doubled this team to ensure that we continue to select optimal managers for our clients.

"We have made some really senior appointments – ie, people with more than 10 years of fund of hedge fund experience. This strengthens the existing team and enables us to manage the growth of our business proactively," he says.

Octane has to date constructed solutions ranging from guaranteed and low risk fund of hedge fund solutions to fund of hedge fund solutions that target equity type returns at bond-like volatility and monthly liquidity.

Theron notes in summary: "We cover the entire spectrum of hedge fund solutions and are therefore able to meet any investor's needs.

As a result of our unique business model and manager research philosophy we believe we are ideally placed to advise clients on their future hedge fund investments." ■



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MANAGING DIRECTOR OF OCTANE PAN AFRICA