

## OFFSHORE HEDGE FUND TRAINING

### *Octane hosts first successful Round Table workshops in South Africa*

#### **Background**

Octane recently held its first successful “Round Table” workshops on offshore hedge funds in South Africa as an extension of the “Brains Trust” sessions Octane has been hosting at its headquarters in Switzerland. Three workshops were held at venues in Johannesburg and Franschhoek, with attendees ranging from retirement fund trustees, financial advisors and investment consultants to stockbrokers.

The aim of the workshops was to expose delegates to some of the basis aspects of offshore hedge funds, whilst simultaneously enhancing attendees’ knowledge and understanding of hedge funds. Each attendee received a detailed “pack” for future reference that included a copy of the workshop presentations, Octane research articles i.e. *Octane Oracle’s* and other interesting articles on hedge funds pertinent to the specific topic discussed on the day.

Members of the Octane SA team facilitated the workshops with Mr. Dennis Hurrell, the Chairman of the Telkom Retirement Fund Investment Committee, invited as the guest speaker – *to talk about the importance of trustee training with specific reference to offshore hedge funds.*

#### **Executive summary**

The day started off with a presentation on “**what are offshore hedge funds?**”. Hedge funds invest in almost any opportunity in any regulated market – this may sound too broad, but this is precisely what a hedge fund is. Hedge funds therefore have access to a broader set of “tools” than traditional investment managers. Hedge funds have been around for a long time – since 1949, with a wide range of alternative strategies being developed over the years – today all “labeled” as hedge funds. No wonder that the term “hedge” creates confusion with investors, as it is a popular misconception that all hedge funds protect investors’ capital during short-term market fluctuations. In reality, not all hedge fund strategies “hedge” the investor during weak markets and only one or two strategies such as market neutral and relative value arbitrage providing capital protection – your so called “less directional” strategies.

The presentation concluded with a brief overview on – “*why the growing interest?*” The hedge fund industry has been experiencing growth in excess of 20% p.a. over the past 16 years. This has mainly been due to the growing interest shown by institutional investors and their consultants with hedge funds providing attractive risk/return characteristics relative to that of traditional asset classes.

The above was followed with a presentation by our guest speaker – “**the importance of trustee training**”. Dennis started off by saying that trustees are all very “busy” and are not remunerated for their services, which are often seen as an interruption to their normal duties. To legislate for compulsory training, courses or qualifications would be very difficult. This however, does not mean that training is not required. Hedge funds are very specialised and it is essential for trustees to be educated on hedge funds in order to empower them in making informed decisions.

Dennis also alluded to the fact that at present no formal trustee training exists for hedge funds and appealed for a formal trustee-training curriculum. Dennis concluded his presentation making mention of the importance for trustees to consider a meaningful allocation to hedge funds to make an impact at the total portfolio mix and the daunting task trustees are faced with manager selection, as the universe of hedge fund managers and funds continue to grow

Octane wishes to express our sincere appreciation for Dennis’s contribution.

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The next presentation dealt with the **“active offshore hedge fund options available to investors”**. Investors could either invest via a single hedge fund manager, fund of hedge fund or a unique option whereby the investor selects a fund of hedge fund model where the hedge fund manager constructs a client specific portfolio by combining a number of fund of hedge funds into a solution. The discussion also dealt with the growing number of offshore single hedge funds and fund of hedge funds available to investors to select from. Institutional investors have a preference for the fund of hedge fund “route” because of the value added that goes with manager selection, portfolio construction and portfolio & risk monitoring.

After a tea break, the focus shifted to manager selection – **“how to select a fund of hedge fund manager in an ever-growing universe”**. The universe at present consists of more than 2,300 fund of hedge funds. It is therefore important for investors to follow a proper initial screening process to reduce the aforementioned list to a more “manageable” list of funds. The liability profile of the investor, performance target, drawdown limits, volatility ranges etc could be used as a first “filtering” tool. Other requirements such as the fund’s track record, size of the fund etc. could be added to the initial filtering process. A considerable amount of time was spent on the aspect of manager size - as research provides ample evidence that size impacts performance.

The discussion proceeded with a brief overview of the quantitative and qualitative screening processes that ultimately lead to an onsite due diligence of the short listed fund of hedge fund managers. In summary, selecting a fund of hedge fund is a daunting task – use the experts!

The next presentation addressed offshore allocation. **“How do trustees go about including hedge funds in the offshore asset allocation mix?”**. The discussion started with a few slides on the role of offshore hedge funds in the overall portfolio mix. The focus then shifted to why investors should not place 100% of their assets in hedge funds despite any traditional quantitative approach indicating an optimal allocation of 100% to hedge funds, as well as investors needing to know that no investment decision can ever 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 etc. impact the optimization results. Clarity was also provided on regulation 28 of the Pension Fund Act – investors are allowed to invest their full 15% allowance in offshore hedge funds.

The discussion ended with a few very important points i.e. consider at least a 5% allocation to impact the risk/return of the fund, make sure the allocation matches the liability profile, keep things simple – use a two stage allocation process and invest as a strategic long term objective.

The session after lunch focused on operational issues. **“What do trustees need to look out for when it comes to operational and reporting issues pertaining the offshore hedge funds?”**. What a lot of investors don’t realize is that more than 50% of hedge fund failures are due to operational risk and not investment risk! It is therefore important for trustees to have a good overall understanding of how the hedge fund structure works, as well investors spending the required time on the operational side of the hedge fund when performing their due diligence exercise. The session also focused on the duties of the administrator, prime broker and what is required from a hedge fund reporting point of view. The last section of the presentation provided a brief summary on what to look out for as a trustee. Issues such as independent pricing, reporting transparency, specialist administrators, late reporting etc were highlighted.

The day was concluded with a brief summary on some of the **“challenges that offshore hedge fund industry faces going forward”**. Surveys conducted by reputable organisations are in agreement that the hedge fund industry is poised for rapid growth – a number of challenges will accompany this growth such as increased competition, the daunting task of hedge fund selection and ability too continue delivering respectable “alpha”. Institutional investors are imposing traditional processes on hedge funds and hedge funds will be challenged to ensure that they have the appropriate procedures and controls in place.

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