



Opalesque Round Table Series '12

SOUTH AFRICA

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Editor's Note

Average South African hedge fund is up more than double the global average YTD

A number of South Africa based hedge funds have received significant foreign interest and sizable inflows from European multi-family offices. There is also interest from US endowments and fund of funds. Similar to multinational corporations that are looking for business opportunities in Africa, astute investors are moving into Africa as well. **South African managers have the skill and experience to deal with emerging markets and frontier investing, in particular Sub-Saharan Africa.**

Initially South Africa was perceived as only a mining-rich resources economy and so the country got predominantly categorized within the resources cycle. Other investors believe there are good investment opportunities in South Africa itself outside of just resources and mining. These investors also recognize the country's highly regulated stock market and financial market system together with its mature fund management industry. South Africa is very well-regulated and advanced relative to a lot of other markets and certainly to the rest of the African markets

The vast majority of South African hedge fund assets is coming from domestic institutional pension fund investors, which led to a very early institutionalization of the industry. Nearly all local hedge funds (representing 99.9% of assets) already use an independent administrator for fund valuations. Client administration and reporting are also commonly outsourced: disclosure and transparency in particular is exceptional: funds representing 70% of industry assets report performances intra-month to investors and funds representing nearly 60% of industry assets actually report their portfolio holdings to investors on a daily basis.

The 2012 Opalesque South Africa Roundtable was sponsored by IDS and Eurex and took place on November 7th in Cape Town with:

- **Carla De Waal, Head of Funds of Hedge Funds, Novare Investments**
- **Genevieve Carse, Business Implementation Manager, IDS**
- **Andre Steyn, Founder, Steyn Capital**
- **Lee Dalley, Skybound Capital**
- **Robert Oellermann, Co-Founder, Tantalum Capital**
- **St John Bungey, Chief Investment Officer, Blue Ink Investments**
- **Uys Meyer, Founder, Blue Alpha Investment Management**

The group also discussed:

- **Regulatory Update:**
 - Pension Funds Act and Regulation 28 now include hedge funds and alternatives
 - The proposed inclusion of hedge funds under the regulatory ambit of CISCA, the local Collective Investment Schemes Control Act, will have far-reaching impacts and can make hedge funds more accessible to a broader market
- **Returns:**
 - The average South African hedge fund is up more than double the global average YTD.
 - Some South African funds of hedge funds returned annualized 8% - 11% p.a. over the past, while the HFRI Fund of Funds Composite Index has returned a muted 1.4% p.a. during the same period.
 - South African hedge funds provided an effective downside protection in 2008.
 - South Africa's hedge fund performances does not correlate as significantly with other emerging markets.
- **Products:**
 - How the early institutionalization of the South African hedge fund industry has contributed to an uniform design of products
 - New products, opportunities in commodities and soft commodities
 - Fund platforms and how to access South African hedge funds
 - How to deal with investors' performance pressure and shorttermism
 - Statistics, opportunities and challenges around pan-African frontier investing

Enjoy the read!

Matthias Knab
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Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, St. John Bungey, Uys Meyer, Lee Dalley, Robert Oellermann, Genene Carse, Carla De Waal, Andre Steyn

Introduction

Andre Steyn

Steyn Capital Management

I am Andre Steyn, Portfolio Manager of Steyn Capital Management which is an alternative manager focused on Africa. We manage two funds: a long/short fund, which is the best performing long/short equity fund in South Africa since inception, as well as a Pan Africa Fund which ranks as the number two performing Pan-African funds since inception.

Lee Dalley

Skybound Capital

I am Lee Dalley from Skybound Capital. We are a multi-strategy fund of funds investment house focusing mainly on high net worth individuals. I have been in the industry since the early days of the hedge fund industry in South Africa, since around 2000. Skybound's management team has been together for approximately 15 years, managing assets for high net worth individuals and institutions.

We had a previous hedge fund of funds business which was bought from us in 2007 by a large South African life insurer. As Skybound Capital we are predominantly focused on high net worth individuals with an increasing institutional client base. We run and manage a range of South African focused fund of hedge funds as well as a range of offshore fund of hedge funds which includes some hybrid style funds. We have a global footprint with offices in Cape Town, South Africa as well as in Hong Kong, London and Mauritius, all accompanied by the relevant regulatory licenses in each jurisdiction. Our client base is a global one as well. We employ 50 people across these offices as fund managers, risk analysts, and in various support functions.

St. John Bungey

Blue Ink

I am St. John Bungey from Blue Ink. I have been in the hedge fund industry since around 2001 in a variety of roles, from fund of hedge funds to single manager strategies and now I am back in the fund of funds world. Blue Ink is the fund of hedge funds arm of the Sanlam Group which is the second biggest life assurer in South Africa. We have a range of domestic multi-strategy and strategy-specific fund of funds that we distribute to both institutions and high net worth individuals, predominantly through the Sanlam Distribution Platform.

Carla De Waal

Novare Investments

I am Carla De Waal, representing Novare Investments, an independent solution specialist in the multi-management and alternative investment space. We currently manage R7.5 billion assets in long-only and alternative funds of funds. We focus on the offshore and predominantly the onshore market. Historically, the largest part of our investor base has been institutional pension funds, but recently we have also received significant interest for our products from the retail side. I head up the funds of hedge funds division, and my team also composes the annual South African Hedge Fund Survey, which in 2012 has been published for its ninth year.

Uys Meyer

BlueAlpha Investment Management

I am Uys Meyer from BlueAlpha Investment Management. I have been involved in the hedge fund industry since the late 90s, both in an investment management and investment development roles. Our current business is focused around hedge fund management but we also run traditional equity, both in mutual funds and institutional mandates. In the hedge fund management side, we are currently focused on equities and agricultural commodities.

Genene Carse

IDS Group

I am Genene Carse. I have been in the financial services industry for 20 years, starting over at Old Mutual and later Alternative Financial Services, and for the past seven years I have been with IDS as a business implementation manager. IDS is a specialist third party administrator based in South Africa and Malta. We have got over 50 clients and administer over 200 funds.

Robert Oellermann

Tantalum Capital

My name is Robert Oellermann and I represent Tantalum Capital. We are a specialist alternative investment fund manager in South Africa managing about R1.6 billion of assets predominantly for South African institutional clients but also some local families, high net worth individuals, and some select offshore investors.

Our fund suite stretches from domestic multi-strategy funds to a domestic fixed interest strategy, and most recently we added a global resources alternative investment fund focusing on resources equities and commodities. The core of our team has been together for 15 years, first in the long only industry, mainly at Coronation, and then in the alternative space since inception of Tantalum Capital in 2005. There are 15 people in our firm, with a nine strong investment team covering all parts of the domestic equity landscape and increasingly globalizing our skills as well.

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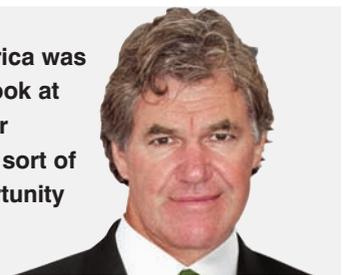
Robert Oellermann: There have been a couple of different angles of international interest. Initially South Africa was perceived as only a mining-rich resources economy and so we got predominantly categorized within the resources cycle. However, over the more recent past, South Africa has received more attention as a gateway into the frontier market of Africa. With that, a second type of investor has become active in our region.

A third type of investor has also emerged more recently: one who is active in both of the first two opportunity sets, but who has also realized that there are good investment opportunities in South Africa itself, outside of just resources and mining, attracted by a highly regulated stock market and financial market system, and by the highly developed fund management industry at institutional and retail level. South African equities in particular have attracted a lot of foreign interest and foreign flow in the last three or four years.

We have most recently launched the Tantalum Global Resources fund which we feel is a product which will be relevant to clients both locally and offshore. This fund focuses on mining resources and commodities. We have excellent expertise in both those areas, with David Fleming, a highly regarded global analyst on the resources side, joining up with Mike Lawrenson from our existing team. Between the two of them, they are covering a wide range of opportunities drawing on their skills and South African mining expertise developed over many years.

This new fund can arbitrage between equities and underlying physical metals, and between the different ranges of metals, between the different equities, but it does not play in the soft commodity space. Again it is providing investors with the opportunity to make money at various points in the commodity cycle. Clearly, it will benefit more generally if commodities turned upwards, but we feel that this is not imminent. The global economy seems almost “paralyzed” by the conflicting forces of deflation (excess capacity and high debt levels), and then by cheap money trying to force reflation and inflation. Of course, we see a massive macro-opportunity in metals and commodities coming out of this cycle, but timing will be crucial. And so we are still now focused on the profits to be made from relative mispricing between metals and between equities.

Uys Meyer: Access to Africa is certainly of interest to people, and while previously South Africa was considered to be part of a global emerging markets allocation, as Rob said, investors now look at South Africa on its own merit. At our firm we have seen a growing interest particularly for our commodity offering. The issues around global food supply and demand imbalances and the sort of inherent food inflation does attract investors, however, the limited scale of investment opportunity does not allow for large flows into the strategy.



Andre Steyn: We have recently seen very significant foreign interest and have received sizable inflows into our Africa fund from European multi-family offices. There is also interest from US endowments and funds of funds. Similar to multinational corporations that are looking for business opportunities in Africa, astute investors are moving into Africa too. These investments are either directly made by brand name hedge funds, or allocated to local funds like ours.

St. John Bungey: We also have to mention that exchange control remains a major impediment for the South African hedge fund industry. From the international investor's perspective, there is still this disbelief that we operate as a largely closed hedge fund industry that specializes in only one market.

We are one of the only hedge fund industries in the world that is largely denominated in local currency not in dollars. There is no doubt that we have the fund management skill but because of the way we have packaged them, they do not look, smell or taste like the hedge funds that foreigners are used to. I think this explains the fact that despite very good returns, very few managers have grown in excess of the magical hundred million dollar mark with their offshore offerings. That said, South African managers have the skill and experience to deal with emerging markets and frontier investing, in particular Sub-Saharan Africa. This broader universe sits well with foreign investors. That is probably why managers with dollar-based African offerings are starting to attract capital.



Lee Dalley: In the past, direct investors coming into South Africa were very much ahead of the curve. The very same people are now looking at the next frontier, which is Pan-Africa or Sub-Saharan Africa. The interest for that new frontier has pretty much caught up and almost taken over their interest in South Africa. These investors have an amazing risk appetite, and they seem to be looking for higher risk compared to what the South African market is offering. So they look at the rest of Africa for bigger risk and higher returns. It seems that unfortunately, a good deal of that money is swinging straight past us and goes right into the African market.



Carla De Waal: Our local South African institutional pension fund investors are still very conservatively positioned, they are not looking at the type of risk return profile that a lot of foreign investors are looking for. The foreign investors want something more spicy - they come to South Africa and expect something akin to other emerging markets, yet the hedge fund performances do not correlate as significantly with other emerging markets. But therein lies opportunity, particularly in terms of downside protection. If we look at what happened in 2008 and to what extent our local hedge fund managers were able to protect capital during the market downswings (and still are), that alone is an attractive offering for offshore investors, maybe not as much as they initially expect from a return perspective, but most certainly from an EM risk reduction perspective.



Matthias Knab

Lee, you have mentioned international money flows past South African asset managers straight into Africa. But don't South Africans also run plenty of Africa funds?

Lee Dalley: Yes, of course, for example Andre and many other managers have dollar-based funds that invest into Africa. So yes, some South African managers and service providers are benefactors of that flow, but obviously the money in those funds is put to work to create returns from outside of South Africa.



Africa has hit the map internationally, and investors are aware of the kind of risk that comes along with it. South Africa is more at the low end of that risk while investors at the moment have more appetite for the higher risk. South Africa is incredibly well-regulated and advanced relative to a lot of other markets and certainly to the rest of the African markets. Are we a first world environment disguised as an emerging market, or is it the other way round? The fact is that our markets are fundamentally more advanced and therefore are seen as having more developed market risks.

St. John Bungey

The opportunity for the South African industry is to be a conduit into Africa. We should work towards setting up the best framework so that foreigners wanting to invest into Africa come in through South Africa. Issues around taxation of foreign investors would need to be addressed, but there is a massive opportunity to house those funds and become the financial center for Africa. I don't know when and if this will happen, but it is a real opportunity for our industry, which compared to some other hedge fund centers is still a rather small one.

Genee Carse

You are right, part of our problem here is the size of the industry. A lot of our domestic hedge funds are rather small and therefore it is not that attractive for a large institution or investors from overseas to weigh through the options here.

Andre Steyn: Still, I see a lot more overseas institutions and funds of funds looking at South Africa. They notice that the average South African hedge fund is up more than double the global average year-to-date, and they are increasingly visiting us to see why. Of course, size is usually an impediment in both South Africa and Africa, and as such investors often employ a basket approach, investing in several funds. In Africa, some investors will invest in smaller than normal size with a view towards scaling the investment as markets mature.



Matthias Knab

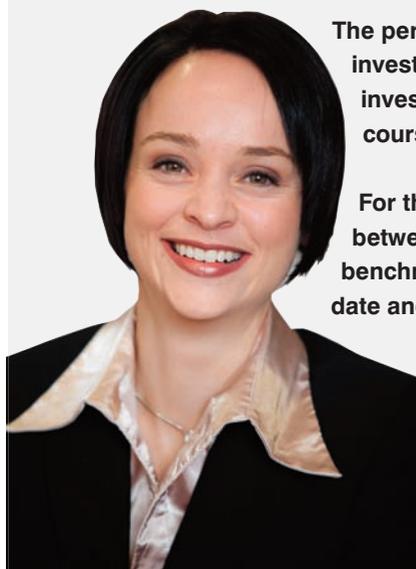
Carla, can you share with us more details of how the South African hedge fund industry fared versus the international benchmarks post 2008?

Carla De Waal: In 2008, our hedge funds held up very well in terms of the global meltdown. Our local market was down 23% that year but some of the market neutral strategies were up 8% or more in Rand terms. Long/short and more directional types of strategies took a bit of a knock that year (on average down between 5% and 10%). After that, the local equity market enjoyed quite a strong run, despite some intermittent drawdown periods (most notably the 8.5% drawdown May 2011 – September 2011 – over this period local hedge funds were positive on average). But even throughout that whole period, hedge funds overall domestically have done very well.

The Johannesburg All Share Index has an annualized rate of return of 8.5% since January 2008 up until October 2012, and the bond market has similarly seen strong buying from both local and international investors, achieving 10.6% over the same period per year. According to one of the local hedge fund data aggregators in the country, long/short hedge funds delivered 7.4%, and market neutral performed within a similar range. Hedge funds focusing on fixed income in South Africa have done very well and over the last couple of years produced double digit returns averaging about 13% per year at very low standard deviations. That part of the industry, together with long/short, has attracted a lot of inflows over the last couple of years.

The performance of South African hedge funds in Rand terms is very attractive. International investors have to take the currency into account. The Rand can be extremely volatile, which investors can decide to hedge out via a foreign currency class investment into funds or of course merely opt to leave unhedged.

For the year to date, our funds of hedge funds (investing in local hedge funds only) are up between 7% and 12% to October in Rand terms – comparing very favorably with offshore benchmarks such as the HFRI Fund of Funds Composite Index that is up 3% for the year to date and the HFRI Emerging Markets (Total) Index that is up 5% for the year to date.



South African hedge funds compare even more favorably when looking at a slightly longer time period, for example our funds of hedge funds products (all with very conservative mandates) have returned an annualized 8% - 11% p.a. over the past three years. This compares with global funds of funds merely breaking even – the HFRI Fund of Funds Composite Index has returned a muted 1.4% p.a. over the past three years.

St. John Bungey: Compared to the international market, we have of course fewer strategies in South Africa. Broadly speaking, we have a number of sub-categorizations of market neutral strategies like conservative or aggressive, but predominantly you find market neutral equity strategies, long/short equity, fixed interest, and then a growing set of commodity, credit funds, and some sort of borderline late stage private equity into listed plays.

While the diversification is narrower than in the offshore hedge fund universe, the returns have been pretty good, even on a risk adjusted basis, if one converts to dollars – compared to international hedge funds, where the returns over the last two years have been pretty anaemic.

As a domestic fund of hedge funds manager, whenever I am traveling abroad, I always compare the managers there to the domestic managers here. For example, we certainly do not lack the investment skill base here compared with managers in New York. It is just that the range of instruments that is available here is narrower. After all, we're still an emerging financial market.



Lee Dalley

The strategies available to funds of funds are fewer, so you need to be innovative in a way to differentiate yourself from a competitive point of view from your peers. You can do this through working with new strategies or derivations of existing strategies like more concentrated or more leveraged versions, or through carving out a particular manager skill set and create some uniqueness to the offering you have for investors.

Carla De Waal

Over the last couple of years we focused on the role of hedge funds in the client's total portfolio context. We are looking at the specific roles and fit of a particular hedge fund allocation within that particular investor's portfolio. We are taking a holistic approach looking at the interaction of alternatives like hedge funds and even private equity with long-only allocations to different asset classes in a client's portfolio. But that goes hand in hand with another theme, which really centers around empowering investors. We believe that going forward, investors will have to be more involved in the whole allocation process and really understand how they are impacted by decisions, as well as the choices and risks surrounding their investments. We as the service provider see this as partnering with the investor to achieve defined outcomes. That is why we don't see ourselves as an off-the-shelf product provider, but as a customized solutions provider to our clients.

Robert Oellermann

Our flagship fund is a domestic, multi-strategy hedge fund that combines the skills of our entire team, but we have also come to realize that a "one-size-fits-all approach" to our product range is too simplistic. We are increasingly offering more specialized funds to our clients, for example high risk and lower risk products, or as Lee mentioned some specific carve-outs of our portfolio or skill set. That is what we did when we launched our new resources product six to seven months ago. That fund builds on the skills that are available in our team, it comes with higher volatility and with higher risk, but for some investors this is the right thing to add to their portfolio and their offering. Two years ago, we also created a more concentrated version of our existing multi-strategy that also aims at higher volatility and higher return from a more concentrated exposure.

Carla De Waal

Hedge fund investors are usually very comfortable when fund managers intelligently broaden their offerings. As investors, you have come to know the manager and his operation, you have done your due diligence on the manager, the business and the infrastructure. It is generally helpful if you have a greater range of different sub-strategies available that you can use in your top-down strategy allocation. It gives you additional tools to work with, otherwise you may have to see yourself forced

to disinvest from a particular manager if your view on a top-down strategy level changes, and go to a totally new manager.

When hedge fund managers are capable of running different strategies within their own brand, that gives us as a fund of hedge funds more flexibility to respond rapidly, move nimbly between strategies and allocate more efficiently from a top-down perspective.

St. John Bungey: We have just launched a commodity fund of hedge funds which is a carve-out of all the commodity holdings we have had across our multi-strategy portfolios for the last three years. The reason we launched it was in response to increased demand for a differentiated, more aggressive product.

Unlike the rest of the world, the South African hedge fund industry jumped the stage of being seeded by individuals and family offices and it went institutional within a year or 18 months of its birth. As a result, from early on, funds of hedge funds were offering low volatility and very institutionally-focused multi-strategy products.



There seems to be some reversion to the origin of hedge funds. Private investors are re-emerging and seeding strategies. They are not that interested in the cash plus mandates favored by institutions. They want the possibility of a 40% one-year return and they don't mind losing 10% on the path to achieving this.

This risk appetite is something new for our industry here, and that was one of the reasons that we launched the commodity fund of funds, because it exhibits those kind of properties. We also thought we'd have to wait for at least six to 12 months before we'd see any serious outside interest, whereas we have already had significant interest in the first six weeks since its launch as a standalone product.

Genevieve Carse: From the administrator's viewpoint, we have certainly seen the characteristics of funds of funds changing over the past three years, their business and investments have become more complex. Funds of hedge funds managers are trying in different ways to differentiate themselves and adding to what single fund managers do in many ways by including derivative overlays or other aspects to their products.

As St. John has explained, the evolution of the South African hedge fund investment market has been completely institutionally -driven, which means that the level of investment reporting and involvement on a month-to-month basis and related investor demands have gone up and added complexity, I mean investors continuously want new and different things. I think it is an important step to have a view of who the investors are and exactly what information they are looking for. This is also driven by increased regulation of the Pension Funds Act and Regulation 28 and other matters.



Matthias Knab

What's new from the South African investor base?

Lee Dalley

Our business at Skybound is focused on high net worth individuals; however, in a previous business we were also managing pension fund assets.

Lee Dalley: When Regulation 28 came out, there was a hiccup in the industry related to the new definitions of the amount pension funds could allocate to hedge funds. It turned out that the more forward thinking institutions actually had over-allocated in terms of what the new regulation would allow them. So rather than seeing massive inflows, the fact that pensions finally received clarity via Reg. 28 has caused outflows out of the market. And because some of



these institutions are relatively large, the outflows were significant.

The good news is that if you're looking at the entire pension industry, there is now a lot more clarity as to the allowed allocations and therefore a broader market from which to attract inflows. Some of the consultants to the large pensions are now beginning to focus time and energy on the alternative investment space and set up focus groups to begin to understand them more. That means we could be looking at more steady flows over the next few years as hedge fund allocations become a standard allocation in a fund rather than an extra. So while Regulation 28 caused some outflows, the consultants now have a clear framework to work with and that will be very positive for the industry going forward as we will see more institutions investing into the space.

St. John Bungey: Whilst not that many South African pension funds allocated to hedge funds in the past, those that did the work had allocated up to 15% or even 20% of their assets, if one includes their offshore allocations. So when changes to regulation was promulgated allowing domestic pension funds a 10% allocation to hedge funds it looked, at face value, like something that was very good for the industry. However, it ultimately resulted in large outflows.

Long term, I think we will slowly get allocations from smaller pension funds, now that the framework to include alternatives has been finalized. The problem in the shorter term is that this has all happened post-2008 in a "risk-off environment." The change in the regulatory framework has happened at exactly the same time that the average pension fund trustee is looking at a world with people who are obsessed with compliance and oversight and not making mistakes.

So I think part of this is just bad timing. When one presents to pension fund trustees, there is a hurdle to drag trustees over. They are saying, "I get the concept. I get that this is now allowed, but this is complex stuff and I am not sure as a trustee that I want to cross that boundary where we might make a mistake."

The other point to make is that the change to pension fund regulations embraced alternatives in general. In addition to the 10% hedge fund allocation there is a direct commodity allocation of 10%, a private equity allocation of 10% and a credit or direct lending allocation of 15%. So broadly as an alternative asset class there is now a massive pool of money to go after but it is only going to come when confidence starts to return and pension funds actually look at the returns they have been getting in aggregate and say, "We need to start taking more risk. We need to start expanding what we are doing to get returns."

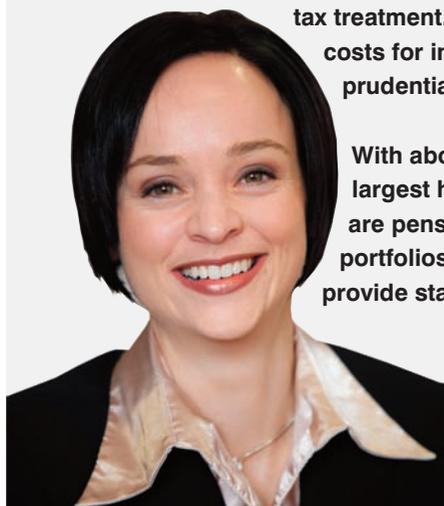


Carla De Waal

Reg 28 as enacted in July 2011 has broader implications within the asset management and financial industry extending beyond hedge funds. For example, pensions now have to report at the member level. That means a lot of systems and operations had to be changed to meet the new reporting requirements. The positive upshot is that pension fund trustees should gain a lot more confidence in allocating to alternatives now that they are doing it within a more regulated environment.

Carla De Waal: An equally important development in the local hedge fund industry has been the publishing of a proposed framework for the regulation of hedge funds in South Africa (joint paper published by the Financial Services Board (FSB) and the National Treasury in September 2012). This framework proposes bringing local hedge funds within the regulatory ambit of CISCA, the local Collective Investment Schemes Control Act, 2002. The promulgation of such product level regulation for local hedge funds will definitely have a far-reaching impact on the local financial

industry and hopefully make hedge funds more accessible to a broader market. This development should also further increase the confidence of institutional investors such as pension funds, as the proposed legislation will mean that they will be able to access these funds through a much more uniform regulated manner. The regulated vehicle should provide investors with a well-understood structure and standardized interpretations of, for example, tax treatment. One might even argue that such a regulated vehicle will reduce due diligence costs for institutional investors, as many features will be standardized or prescribed through prudential regulation.



With about 66% of the assets, funds of hedge funds have historically been (and still are) the largest hedge fund investor in South Africa. As the majority of our investors, about 70-80%, are pension funds, firms like ours tend to follow an “institutional” mind-set and position the portfolios very conservatively – our funds are used to reduce risk in the total portfolio and provide stability during market drawdowns, rather than merely to enhance returns.

The pension fund market is vast. Regulation 28 applies to all private retirement fund assets, which is understood to be worth in excess of R1.1 trillion. Furthermore, Regulation 28 may be extended to the Government Employees Pension Fund which will capture an additional R1 trillion in assets.

And as we have already pointed out, the amended Regulation 28 now allows pension funds to invest up to 10% of its total assets in hedge funds. However, before any investment will be made, the onus on industry participants and pension fund consultants alike will be to empower pension fund trustees with the necessary understanding and knowledge of the benefits of its inclusion, as well as the risks involved with any investment. We have to educate our trustees that they understand all aspects of investment - not merely “alternatives” but investment in its broadest sense, the interaction of risk and return and the impact it has on portfolios. Only then will they be able to appreciate the role alternative investments can play in the portfolio and may we resultantly see more money flowing into the industry.

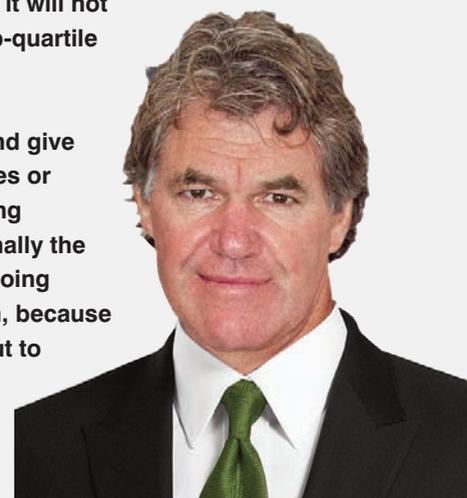
Genee Carse

CISCA is the Collective Investment Schemes Control Act governing financial services providers. It is really a product-focused regulation. Hedge funds are outside of CISCA, although there are currently proposals on the table to bring it under that regulatory umbrella.

Uys Meyer: There is one systemic issue or conflict when it comes to our hedge funds' performance that hasn't been properly addressed or disclosed yet. The fact is that all consultants, the institutional gatekeepers, are foremost focusing on the risk side of the investment process and demand conservative, highly diversified portfolios, which is fine and the hedge fund industry can certainly provide that. The problem starts when the same consultants or investors in general start to benchmark our returns against an unrestricted traditional long-only fund manager. If hedge funds are forced to operate in such a stringent risk-controlled framework, it will not always be possible to beat a traditional long-only fund manager who is in the top-quartile or sometimes even outside the top quartile.

Luckily for us, the investors behind the family offices are more return-focused and give us the opportunity to create a different type of product. Traditionally, family offices or high/ultra high net worth investors want to be invested directly with the underlying manager. So for us managers, these are two distinct investor bases, but traditionally the bulk of the assets used to come from the people focused on risk. I believe that going forward, the consultants and institutions may have to extend a bit their approach, because investing into hedge funds with that overwhelming focus just on risk may turn out to be too limiting over the long run.

Another issue is the crowding of the pensions into the very large funds, which



then tend to be highly correlated to the equity returns of the traditional industry. The institutions and consultants will have to work on a really sophisticated approach, the solution is not that simple. Until the framework has been developed that allows pensions to better benefit from the risk-return and diversification benefits hedge funds potentially offer, the money flows from the institutions may still be a bit constrained.

Genene Carse: In the end, it comes down to education, which by definition is a long term process. A more differentiated framework is required. For example, we as administrators can often see the same institutional investor reappearing in different funds of funds, but because the same risk management and top-down approach has been applied by their consultants, the industry tends to become more homogenous, even though you wouldn't think so if you'd just been looking from the outside.



Another factor that restrains hedge funds, at least here in South Africa, is that the Public Investment Corporation, the government-owned investment manager servicing the public sector and the Government Employees Pension Fund do not really look at hedge funds yet, and a lot of trade-union aligned pension funds look to the PIC and the Government Employees Pension Fund when it comes to what is appropriate to invest in. There is a lot of crosstalk at that level, but hedge funds are not yet a part of that conversation.

St. John Bungey: Internationally, the hedge fund industry evolved overseas with high net worth and family office investors as the key investor base. Our local industry, for better or worse, has evolved differently here in South Africa, because demand for hedge funds primarily came from pensions via funds of funds as the key allocators. The typical fund of funds model was always to take different volatile managers, deriving returns from different investment methodologies or asset classes, and put them together in a way that the aggregate fund was less volatile. So, the institutional demand has inadvertently created similar products - lots of low risk and predictable alpha. Everybody wants 5% or 10% on a predictable basis rather than 30% or 40% in a good year and then lose 15% in a bad year.

Therefore, the early institutionalization of our industry in South Africa has driven the kind of uniform design of our products, whereas it would probably be preferable to have a lot of different alternative strategies doing very different things. But the truth is that the demand drives what we do as managers. We would like to think that's not the case, but at the end of the day this is what is happening. Until the demand mix changes, it is unlikely that the hedge fund strategy mix will be different.



Carla De Waal: How do we stimulate product and strategy innovation? As we know, the demands from regulations and compliance coming into force will increase the barriers to entry. Consolidation will make the larger managers even larger and decrease the number of smaller managers. Do we need more incubator setups?



St. John Bungey

I do not have a very good answer to that question. This is not really about growth or number of managers. We have a lot of hedge fund managers here with adequate skill.

St. John Bungey: What has to happen is to go back to the approach of co-investment. Focusing on how managers made their money and how they choose to manage their own assets, and then joining them in that investment, if we like what they are doing and the way they do it.



Lee Dalley: Remember there was a period of time before the crash where our industry's performance here went sideways. Institutions threw their hands up and said, "hedge funds are not giving me what I expected." There were preconceived ideas that they would get a particular return profile from the funds regardless of the market conditions. This misunderstanding or mis-selling caused uncertainty amongst institutions and it also caused managers to be super conservative in order to deliver on this expectation, thus thwarting skill and creativity.



I believe any manager will be delighted to hear from a client "I want 40% but I am prepared to give up 15%" – that would be the greatest thing, but there are those perceptions that hedge funds make money in all markets or that they never lose money. That type of statement should be banned from this industry. I think letting go of these catchphrases allows more risk to be used which in turn allows managers to be a little more creative.

Gene Carse

I believe that pressure for predictability and risk control from the institutional investors that in the end constrains the single fund manager also comes with a great deal of angst when they look at each month's return.

Uys Mayer

Well, the focus today is daily risk reporting and transparency, not month-to-month.

Gene Carse

Correct, and it's a lot of data, it is not really clear to me if it is possible at all to reflect and actually get some insights from daily data in a holistic or systemic way.

Robert Oellermann: The performance pressure and short-termism has increased as a consequence of the global financial crisis and what has followed since. It is a low return environment where everyone is fighting for their slice of the pie.

As fund managers, we have to accept that our clients are under pressure and they cannot accept significant drawdowns in an environment like this. There is thus this tension of having the courage to manage the portfolio for the long term, "floating your own boat" in a way, to achieve the best long term results, but then also having some pragmatism, and offering clients a subset of that fund or different strategies in a way that suits them. It is that sort of creative tension that we probably have to be living with.



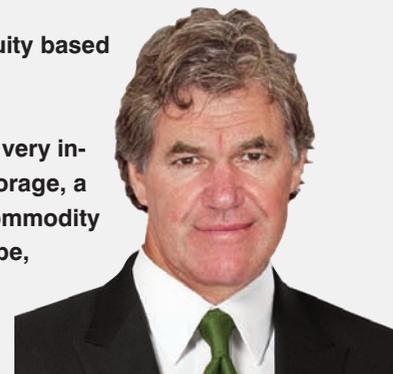
Matthias Knab

Some of you have already floated new boats and come up with some innovative funds that also address the issue of the increased correlation of hedge funds to equity markets. Let's look at the new funds you have launched recently?

Uys Meyer: Agricultural soft commodity prices have no correlation to GDP growth numbers, interest rate patterns or decisions from policy or central bank committee meetings. They are for the most part a function of global supply and demand. Our new soft commodity fund is a non-directional fund that focuses purely on price arbitrages of the same commodity on different exchanges. We also look at how commodities are replaced at the production level depending

on certain price patterns. It is a product that is very different from fixed income and equity based investments.

This strategy is primarily influenced on what happens on the physical side. You need a very in-depth expertise and very good data about what happens on the production side and storage, a huge amount of detailed information that will allow you to understand pricing of that commodity in the future markets, which can stretch across many different exchanges in U.S., Europe, Australia and South Africa. So, in order to play those things, you have to pay a lot of attention to what is happening in the fundamental market.



We have a domestic and offshore version of the product. We have also started working on two other new products. One of them will have the speciality that we will interact between the financial markets through the futures contracts with some strategic physical position taking. Sometimes there are big inefficiencies between the derivatives and the physical markets. As in all of these contracts, you can directly take physical delivery or execute a smooth closure of your futures position.



Robert Oellermann: Our recently-launched Global Resources Fund has a wide mandate and is looking to exploit opportunities on both the long and short side in the resources and commodities space. The fund started at a tumultuous time in the resource markets, but has done well to preserve capital since inception. Different from a lot of other hedge funds in the South African space, we have always felt comfortable playing in the resources sector in our fund where appropriate, as we have very strong skills in this area. Our new vehicle is really enhancing what we have already been doing for a number of years and putting it into a bespoke solution for clients.

St. John Bungey: I am very excited about the developments in the commodity space. Our newly launched commodity fund of funds now allocates to five managers, and all of them aim to deliver a different return stream than the traditional equities and bond hedge fund managers.

We are conducting deep research also looking into other strategies, like pan-African investing. If you go outside of commodities in that region, liquidity becomes an issue. But investors demand different strategies and different things, and there are quite a few managers out there doing some really interesting things in Africa, for example in the off-market debt and the mezzanine finance space. There are some managers here in South Africa active in short-term private equity or as activist investors.



The problem is that investors are asking for the new, the different, the uncorrelated strategies, but if they don't come with monthly liquidity, then they are not interested. That is of course in the way of seeding or developing new strategies with reasonable assets, because it has become very difficult to raise money with say a six months lock-up that is required to run some of these new strategies.

Uys Meyer

We have come across investors interested in the corporate credit space asking for the 10-year spread, but they will not give you three months liquidity in a fund. They are completely disconnected from the reality. Even if a lot of the corporate bonds can be fairly liquid, as a whole they can't be considered liquid instruments as a lot of them are bought by institutional investors and kept to maturity. So while there is a demand for products to go up a bit on the yield curve, the very short term liquidity requirements from the investors actually prohibit these funds from springing up.



Andre Steyn: The price for pursuing inefficiency is liquidity and therefore for a fund manager, that price translates into managing smaller funds. Our entire investment philosophy revolves around looking for inefficient markets, and as a result we have closed our South African fund at a relatively modest R300 million and we are soft closing our African fund right now at \$50 million and we will hard close at \$100 million.

Matthias Knab

Let us talk about pan-Africa or sub-Saharan Africa investments. How can this continent be accessed?

Andre Steyn: There are approximately 90 pan-Africa fund managers, controlling around \$5 billion. In addition to a few long running foreign funds, it has been a trend among South African hedge fund managers to set up Africa funds, and I believe there are now several players who have demonstrated their ability to deliver alpha by pursuing market inefficiency in Africa. It is a relatively illiquid market, and I believe it is important to limit the size of your fund to avoid the risk of turning into an index fund.

Africa has 25 stock exchanges, the largest of which outside of South Africa are Egypt with a market capitalization of \$70 billion, and Nigeria, with a market capitalization of \$50 billion. Currently, we see quite a lot of opportunity in those two markets.



Egypt was quite severely battered by the Arab revolution that sent the stock market down 50% last year, so the market there is trading at about seven and a half times a rather depressed pretax earnings. We think the situation there is quite interesting and therefore we have a significant portion of our African portfolio in Egypt.

Nigeria's stock market is similarly cheap, having not yet recovered after a nasty banking crisis in 2009. While several banks have shown dramatic increases in earnings over the last three quarters, investors are not giving them credit for this high rate of growth because they are awaiting the audited results. The background for this hesitation is a situation we experienced last year where the banks also showed very strong growth in the first three quarters of the year but then deteriorated significantly in the fourth quarter. However, the reason for that was accounting based because of a non-recurring regulatory action. As a result we have significant positions in several Nigerian banks.



Andre Steyn: Africa is not entirely the Wild West even though some of the companies there could use some PR help, with one company called Conoil and another company called Crookes Brothers! We have probably identified about half a dozen completely fictitious businesses and so we are quite eagerly awaiting a short-selling capability throughout the rest of Africa.

Matthias Knab

Lee, can you tell us more about your infrastructure at Skybound and how you create products in between your South African, Hong Kong and London operations?

Lee Dalley

We have managed to develop quite a unique infrastructure having a Hong Kong based office as well as a London based office both with very experienced investment professionals in each of those offices. We call on that skill on a regular basis in terms of global insight and the ongoing

management of our funds locally in South Africa, and obviously those skill bases manage our international portfolios. There is a substantial benefit in having your own people on the ground in those jurisdictions in terms of understanding the developments and viewpoints of the markets there.

Our China and Asian funds are run out of Hong Kong by a Chinese national who has lived and work in China, as well as globally. He speaks the local language and obviously understands the local culture. These are very important attributes when looking at investing in other regions. We would not like somebody who is living in London to be managing a China focused fund. We manage our more global portfolios from London. In addition to our South African based funds we also manage a micro-financing fund with exposure into a number of African countries. It is an alternative, niche fund, and we are amazed at the level of interest this fund is getting from Europe and other parts of the world. The demand for such financing opportunities in Africa is substantial. Our global fund of funds has exposure to Africa and other emerging markets, including some allocation to the selected developed markets

Lee Dalley: In South Africa we are currently launching a very concentrated portfolio where we aim for the higher returns as we discussed a little earlier, with slightly more downside tolerance. This specific fund will have four managers with preference given to two. Interestingly three of the funds are brand new segregated accounts with specific mandates that we have carved out of existing underlying managers once we have understood where the bulk of the managers' returns have been coming from.

We have the fortune of having more adventurous clients because they are high net worth individuals, I do not think we could pitch this to an institution just yet, but maybe at a later point when there is a track record with some good returns, we could look into it.



St. John Bungey: From my experience having co-managed an African credit fund, I can confirm first hand that you're taking liquidity risk going into Africa, whether you are investing into an exchange or whether you buy off market instruments. Bar South Africa, Egypt, and Nigeria, you certainly have significant liquidity risk even in listed investments.

My take always was and still is that there is a complete absence of access to capital in Africa. There are fledging equity markets and almost no debt markets. Where debt markets do exist, the private borrowers are completely crowded out by government. So the type of things Skybound and others have been doing in the debt and mezzanine finance space in Africa represent a huge opportunity for fantastic yields - if you are prepared to bear the liquidity risk.

To speak to an earlier point, the question is finding investors with the liquidity appetite to match that opportunity. The African Credit Fund is still running with a 12% dollarized yield, with all interest serviced and paid. Those are the sort of deals you can attract out of financing in Africa.



Uys Meyer: Just to add up to the liquidity risk, the Zimbabwe Treasury department couldn't place their bills yesterday. It offered a compulsory yield, you couldn't bid for the yield but had to take it. All the banks had received letters of reprimand today for not participating in the auction.



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Offshore investors can use dedicated platforms that have been put together for international investors to invest into South Africa domiciled hedge fund managers. Can we talk about those a bit more in detail?



Andre Steyn: Our Africa fund is domiciled in Malta on a platform which is administered by Investment Data Services, which is the same administrator we use in South Africa. It was a highly cost effective solution, and we benefit from being within the EU which makes marketing in Europe a lot easier.

Genene Carse: At the moment, we administer various offshore platforms via our Malta operations, four are actually Malta-based and one is Cayman-based. At the moment about 25 funds are offered, a variety of funds of funds and single funds. The total assets under administration on the platforms are about R 3.5 billion. There is a growing interest in opening funds there.

I think the Malta environment is quite efficient. Malta's regulators are very efficient in dealing with and setting up funds. We do get fast responses from them, and they have set up systems and procedures for it which also makes it easy from our point of view.



Robert Oellermann: Currently, our resources fund is on a platform offered by SA Alpha. SA Alpha was established to provide international investors access to South African managers' hedge products. The domestic offerings are fully hedged back to dollars. The platform is administered by Altree Fund Services and our Global Resources Fund is prime brokered by Deutsche Securities. In addition to the SA Alpha platform, we have also offered the pari passu version of our Tantalum MNC Fund (our domestic multi strategy fund) hedged back into US dollars, as a segregated account to an offshore investor.

St. John Bungey: Whichever platform people choose when trying to attract assets from offshore, the managers need to be aware that the global funds of funds and international family offices have a checklist of exactly how they expect their hedge funds to look. So any South African manager wishing to internationalize should make sure they use an efficient platform that can take the skills offering here and package it in a shape and form that people are used to seeing, using the same prime broking formats, using the same jurisdictions, and so on.

Back in 2005 and 2006 many managers here made the mistake of just taking their domestic offerings and trying to staple them together into a kind of framework that they thought would appeal to international investors – but it didn't work. From an operational due diligence point of view, a lot of things that are expected are pretty much set – there are certain things people want to see and certain functions in an operation. That is why it is so important that people partner with a good international platform.



Andre Steyn: From an operational perspective, mainstream South African hedge funds are set up in a world class fashion. The use of prime brokers, custodians, independent administrators, risk managers, and mandate compliance

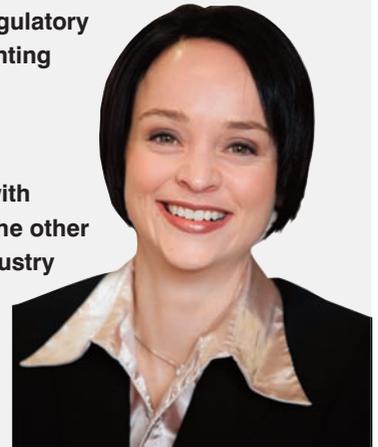


consultants is almost universal. And having worked for a billion dollar SEC-registered hedge fund in New York and a FSA-authorized hedge fund in London, I can assure you that getting a license from the local Financial Services Board here in South Africa is a far more arduous process than any of those two.

The only deviation from the best of breed international hedge funds may be that the operational team here is often not as developed as overseas investors might like. This is a function of the smaller industry here but also because our local prime brokers render a lot of the back and middle office administration for our hedge funds, and that enables our firms to run efficiently with relatively small operational overhead.

Carla De Waal: South Africa’s hedge fund industry has been characterized by high self-regulatory standards even in the absence of formal regulation. Nearly all local hedge funds representing 99.9% of assets already use an independent administrator for fund valuations. Client administration and reporting are also commonly outsourced.

Interestingly, however, the majority of local hedge funds still use only one prime broker, with funds representing a mere 3% of industry assets using more than one prime broker. On the other hand, disclosure and transparency in particular are good – funds representing 70% of industry assets report performances intra-month to investors and funds representing nearly 60% of industry assets actually report their portfolio holdings to investors on a daily basis. The norm is still for monthly investor subscription and redemption though, but this will most likely change once hedge funds become regulated under CISCA.



Matthias Knab

We already spoke about the pension fund regulation with Reg. 28, but now it seems there are more regulations coming out of Pretoria. What is the latest here?

Genevieve Carse

A White Paper was released in September 2012 by National Treasury and the FSB proposing a regulated hedge fund product within the CISCA environment. Some of us here – Rob, myself, and Carla, have been working on this quite intensively. The process and anticipated timelines are not completely clear. However, the expectation is that a joint work group of National Treasury and the FSB will evaluate the input received and then hopefully engage further with industry stakeholders and participants to work out the detail.

Genevieve Carse: It is possible that some kind of announcement is made during the budget in February 2013, and under the current CISCA environment hedge funds can be declared as schemes by the Minister. What transition arrangement is in that event is not clear. I think a lot of thought has gone in what the future will look like from various perspectives, but how we actually get there is not completely clear to me at this point.



I think there is broad based support for a regulated product, but it is in the detail, the associated cost, achieving regulated symmetry in CISCA between the traditional CIS funds and what are now deemed as hedge funds. The proposal is to allow for a two tier product structure, namely “Retail Access” funds modeled on the UCITS framework as well as “Restricted Access” funds which will resemble professional investor funds. The main difference will be in the eligible assets allowed, as well as potentially the governance structure.

The vision is that you will have retail investment funds with UCITS-like characteristics and the expanded mandates from what you currently have under what we call Board

Notice 80. This could also allow collective investment schemes in securities expanding that to the retail investment funds. Under professional investor funds the emphasis will be on upfront disclosure and reporting. And really, our industry here already meets many of the world's standards in how we are reporting this and how we disclose to investors upfront. I think the challenge is going to be in convincing the regulator on who fits in where and what are the governance structures for both of these products.

The governance structure, as is current practice under CISCA, can potentially be onerous as it requires a MANCO which entails a certain cost structure of its own. Then also third party administrators are not sufficiently covered by FAIS at the moment, and there is other legislation that needs to be looked at as well. One of the proposals includes a hosted MANCO solution where fund managers can host their funds.

Carla De Waal

A lot of the ideas that were put into the framework for the regulation of hedge funds in South Africa originated from UCITS, so there are issues around the applicability and uniformity of some of the terminology being used, for example locally they will allow short-selling whereas short-selling is not allowed in previous, more dated versions of UCITS. Some technical issues still need to be sorted out as well pertaining to the transitional period. What happens when all the schemes are declared - will managers have a choice as to which of their existing funds they want to bring under the CISCA umbrella? Will they have an option for example if a fund is wrapped in a life wrapper that does not fall under CISCA, to remain governed purely by the Long-Term Insurance Act that governs life companies issuing these policies?

I believe we all hope that the industry will be accessible to the broader market which thus far has not had the ability to invest in local hedge funds. It will probably require the setup of new types of funds because the managers will be more restricted in terms of eligible assets, exposure levels, etc. that will be determined by regulations, compared with now where the fund's investment activities are governed by the mandate alone. There will also be more clarity in terms of marketing of hedge funds. Up until now, hedge fund products are deemed to be unregulated and as a result are not allowed to be marketed to the public. The new legislation should also bring the necessary tax clarity so that investors will understand all facets of the investment.

If you look at UCITS, risk management has become more and more important. They have chapters dealing specifically with risk management, and the proposed framework for regulation of local hedge funds has also incorporated a dedicated risk management section; however there is not much detail provided in the proposed framework on exactly what this needs to entail. We hope the Regulator will continue engaging with the industry in refining these regulatory aspects, as it is in everyone's best interest, most notably in the best interest of investors. The FSB and National Treasury have a mandate to monitor systemic risks and we understand that this means they seek a level of oversight over all pools of money which includes the hedge fund side. We acknowledge that more clarity on the regulatory front should eventually lead to more inflows in a growing industry which also benefits all stakeholders.

Genene Carse: It is interesting to note that in South Africa's report to the Financial Stability Board in June 2012 they have confirmed that the obligations regarding hedge funds have been met, first because hedge fund managers – but not their products yet – have been regulated since 2007, but also because the focus is on counter parties and the banking entities. They correctly realized that the hedge fund managers themselves do not really pose a systemic risk and that the data needs to be aggregated from the counter parties.

The real issue with CISCA is how you fit the 50+ billion Rand hedge fund industry into a trillion Rand traditional asset management industry within the same product framework, there will be some friction and adjustment issues. The culture, infrastructure and procedures of the two industries are to some degree different, and the task is really how to achieve regulatory symmetry across these two different industries.



Andre Steyn

When you read the newspapers a few years back, they would say, "hedge funds, unregulated pools of capital" and then it changed to, "lightly regulated pools of capital." It seems the definition is going to change again, and my concern is that at some point we may be longing for the old days.



Andre Steyn: I am always worried about unintended consequences of regulation. One of those could be that we have to water down our products to an unreasonable degree in order to make them suitable for retail investors. We already talked about how the institutionalization of the South African industry has created those rather uniform products with very low levels of volatility, and adapting the industry now to retail may further exacerbate this. Having said that, it looks like the regulations will also allow qualified investor funds which will operate in the same way as we are doing it now, and that is the key aspect for me.

Matthias Knab

From the perspective of an international observer, South Africa has made headlines globally for internal political and economic reasons like the miners' strike, corruption and what's boiling inside the ANC and how Zuma is doing his job. How do these things affect the markets and your funds?

Robert Oellermann

The South African economy and the South African market have a history of getting on with things almost in spite of politicians and in spite of the environment that it operates in. We are used to operating in a fairly volatile and quite emotionally charged space, so for the domestic investors, the headlines you referred to are not new. International investors may have to learn how to live with and properly evaluate these things, but again, for the local managers this is not new and many of us have steered the boat through decades of very volatile events and still successfully managed our assets. Of course, you always need to be sharp in your thinking and in your assessment of risk and of value.

Carla De Waal

You are right, and while as you said the domestic managers are capable of managing money under varying market conditions, I am more concerned about the increasing impact of foreign investors on our equity and bond markets. These investors are by definition geographically removed from our markets, but the increased flows from foreign investors into Africa can also readily revert, causing larger anomalies given their relative size than before. For example, South African retail stocks or the bond markets have been impacted by changes in the perception of foreign investors. These external influences can hurt or counteract the fundamental longer-term view which a domestic manager may have in place. Whole strategies like relative value can be affected. You can have all the skill in the world, but you can't really risk budget for some of these external macro factors that impact markets globally and lead to disproportionate domestic flows. Local managers will need to be a lot more cognizant of these external forces or macro factors in their risk management process.

Matthias Knab

I am doing these Roundtables globally in all major financial centers, and I can tell you the increased importance of the macro events when managing your domestic market has probably never been as high. We had U.S. and Asian equity hedge fund managers at our Roundtables sharing how they stay up at night and watch the outcome of the third Greek election in 2012, what Merkel and Draghi will be doing etc., because the macro drives the local markets like maybe never before.

St. John Bungey

I have just finished an article on this subject. South Africans are very myopic about their own country. We tend to think that everything that happens to our currency or markets is driven by domestic events. We also tend to move from wearing "rose-tinted" spectacles, to "dark glasses" with very little in between.

St. John Bungey: Much of what happens depends on the world's attitude to emerging markets. And yes, in the past couple of months there have been some specific developments that have definitely driven specific risk, but if I reflect on my 20 years in the markets, it seems like it's part of human nature to get ultra-negative as people extrapolate the most recent events and fast-forward them to absolute disaster.

If you, as a professional, can manage to stay calm and rational, you can often see that such a phase has always been an inflection point in South Africa. It is usually the time you should have been buying or at least emotionally starting to commit to finding the opportunities.

Coming back to the international investors, I find a good number of them are also reasonably pragmatic. We just hosted some investors from London who are considering investing in South Africa, and they see the volatility as an opportunity to make money going forward. The trick is, you have just got to keep your head.



Robert Oellermann: It is a long time since we have seen such macro-dominated markets. Investors seem polarized between cheap cyclical shares and expensive defensive shares and bonds. The strong momentum behind 'safety' in some ways reminds me of the tech boom 12 years ago, where value considerations seemed secondary, and you were either 'in' or 'out' of technology stocks. Eventually, this will no longer be the 'safe' trade it seems.

As a manager you can choose to embrace the momentum, or you can choose to operate outside that trade. In my view there is still enough money to be made outside that trade and not by being hypnotized by the macro. Of course, I acknowledge that we are in a very dangerous time globally, but as domestic managers we have to beware of this global polarity. Those who are nimble enough and do not run an index fund of sorts will find that there are still well-priced companies out there that are doing well irrespective of the environment. That is really where we are trying to focus our research.



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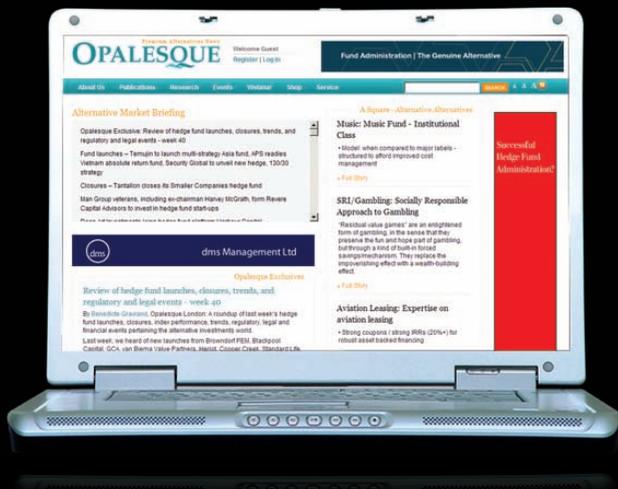
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