



Hedge funds

Stuck in a rut

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Until recently, hedge fund managers had a reputation as masters of the universe. A few in the US still do, with Steve Cohen, for example, taking a 50% performance fee on his SAC fund.

The mystique of funds was increased as the public could not access many funds directly — and certainly not if they had less than R50m to invest.

Yet over the past two years the industry has stagnated, with no increase in total assets under management.

Compared with most international markets, rich speculators play only a marginal role in the SA hedge fund industry. Pension funds are the main source of capital for local hedge funds, which invest primarily through a dozen fund of hedge fund managers.

The single biggest obstacle to the growth of hedge funds is Regulation 28 of the Pension Funds Act. This allows no more than 2,5% of fund assets to be invested in hedge funds. Institutions used to get around these rules by, for example, investing through debentures which allowed a 5% exposure. But under the proposed “see through” approach in the revised Regulation 28 this loophole will be closed.

Fatima Vawda, who runs the 27four fund of hedge funds, says there has been movement between funds of hedge funds over the past two years — Brait was the largest player but it has now been overtaken by Edge Capital.

And while there was a surge of new funds from 2003 to 2006, the trend is towards closing funds .

Pension funds prefer to use funds of hedge funds rather than investing directly in hedge funds as they get a diversified portfolio and they get someone else to monitor the managers. But the returns from these vehicles are not exciting compared with what is available from alternatives such as private equity or Africa funds.

The returns from funds of hedge funds over three years have varied from 1,58% for Blue Ink’s unfortunately named Supernova fund to 11,41% for the Alpha Fixed Income Blend of Funds. Good private equity or Africa funds have provided annualised returns of 50% in many cases.

Willem van der Merwe, co- manager of the Sygnia funds of hedge funds, says: “I believe they have a very fair payoff profile, with much lower volatility than equities [see graphic]. ”

Vawda says a high-profile fund, Oryx, run by Heiko van Wyngaarden, has been a big disappointment, with poor performances recently. But so far there has been only one hedge fund collapse, Evercrest, five years ago.

Hedge fund managers are now regulated under a special category (2A) of the Financial Advisory & Intermediary Services Act. Vawda is concerned that fund managers will have to put up R3m in unencumbered capital. This sounds nominal for the large asset managers such as Coronation and Investec, but Vawda believes 20 managers with less than R100m under management would go out of business if they had to put up this amount.

Robert Foster, who chairs a committee that is negotiating hedge fund regulation with the Financial Services Board, says he expects the FSB will allow managers to count any investment they have in the fund towards the R3m.

Foster says a major frustration is that the FSB does not yet recognise Ucits III, the legislation governing European collective investments. This would allow "hedge fund lite" products, which would be permitted to do limited short selling of shares, for example. These products would be available to a much broader market than the one that hedge funds currently serve — R500/month debit orders, for example.

Foster says Europe will soon introduce Ucits IV, indicating how far the FSB is behind the curve.

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