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Editors' Note

Dear Reader,

The World Economic Forum's Global Competitiveness Report, which had 159 participants, **ranked South Africa as number one** in the strength of auditing and reporting standards. In the regulation of securities exchange, South Africa came in as number one as well.

No wonder that hedge funds are doing well in South Africa. A recent report said assets are up 8% reaching 32.1 billion Rand, new funds and new strategies are being consistently implemented and launched, however the best is yet to come. A **new regulatory framework** has been proposed that would **effectively double if not triple the limits pension funds can invest in alternatives.**

The South African hedge industry offers a very attractive proposition and can compete favorably with other hedge fund jurisdictions in terms of return generation, risk management, independence, transparency, custodianship and liquidity. The local infrastructure offers sophisticated prime brokerage, derivatives and script lending capabilities.

Africa, Africa!

For many investors, the "Africa story" is compelling from an emerging market growth story, because of its youth - 1.1 billion Africans will be of working age in 2040, and natural resources, including its rivers and land - 60% of the world's total amount of uncultivated arable land is in Africa.

South African managers can serve as a conduit for pan-african investments, but is it really a requirement to run Africa funds out of Africa, or can they also be managed from London or New York?

The Roundable was sponsored by Investment Data Services and took place in their Cape Town office with:

- **Leila Kuhlenthal,** Head Business Development & Capital Introduction, Peregrine Group
- **Ian Hamilton,** Chief Executive Officer, Investment Data Services Group
- **Norman Au,** Head of Prime Broking, Investec Securities
- **James Gilfillan,** Director & Senior Portfolio Manager, Alpha Asset Management
- **Murray Todd,** Portfolio Manager, Edge Capital
- **Tony Christien,** Director, Investment Data Services

We also thank the 2010 Roundtable Series sponsors Custom House Group and Taussig Capital for their support. Enjoy "listening in" to the 2010 Opalesque South Africa Roundtable!

Matthias Knab
Director Opalesque Ltd.

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Cover Photo: Cape Town and Table Mountain. Picture by Matthias Knab.

IDS GROUP

United Kingdom
Europe
Africa
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Who we are and what we do?

The IDS Group is an independent fund administration group which was founded in 2002. We specialise in providing back office services to alternative asset managers including hedge funds, funds of hedge funds, private equity and property funds. We are the largest fund administrator in Africa with assets under administration of approximately $6bn and international offices in London, Malta and Mauritius. Our clients trade all investment strategies and we pride ourselves on providing a tailored solution to meet their differing requirements.

What sets us apart?

Understanding your business is our business. Our clients vary in terms of size, location and complexity but we treat every client as an important client. One size does not fit all. Our experienced team work with our clients to ensure complete understanding of their requirements and provide detailed and bespoke solutions as well as ongoing advice assistance and support. We continually review our processes and integrated range of products and services to ensure we maintain the high service levels that our clients expect from IDS.

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Participant Profiles

(LEFT TO RIGHT)

Tony Christien, Ian Hamilton, Murray Todd, Leila Kuhlenthal, Norman Au, James Gilfillan, Matthias Knab

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Introduction

Tony Christien
IDS Group

My name is Tony Christien. I am with the IDS Group. We are a specialist fund administrator in South Africa where I am primarily responsible for the South African client base, which includes hedge funds and other Africa-focused funds.

Murray Todd
Edge Capital

My name is Murray Todd. I work with Edge Capital where I am on the portfolio management team. We are a multi-manager specialising in alternatives. We do have related companies that also engage in private equity and mezzanine finance, all focused on South Africa. I also consult to an offshore manager, All Seasons Capital, which amongst other products manages an African long-only fund of funds.

Leila Kuhlenthal
Peregrine group

My name is Leila Kuhlenthal; I am in charge of business development & capital introduction for the Peregrine group. We are a dedicated wealth and asset management company and have approximately $10 billion under management, half of which is based in South Africa and the remaining half offshore. At the heart of our business lies interaction with financial markets - through investing our clients' capital, facilitating investment of clients' capital and investing the group's own capital.

Ian Hamilton
IDS Group

I am Ian Hamilton and also part of the IDS Group. Here on this Roundtable I also represent the Lions of Africa, which is a Cayman-based platform of investments into Africa, particularly hedge funds that invest into Africa. We are also launching a Malta-based platform called the Knights of Malta, which will also have certain significant African interests as well.

Norman Au
Investec

My name is Norman Au, I head up the Prime Broking Division within Investec. We offer a myriad of prime broking services, including capital intro to fund of funds, hedge funds, et cetera. As part of the Investec Group, we also provide access to a whole host of Investec services from structured products to money markets, fixed income, futures, banking etc.

James Gilfillan
Alpha Asset Management

My name is James Gilfillan from Alpha Asset Management, which is an asset manager in the alternative and long only space managing $800m. Essentially, our business is a combination of asset management and family office services with a focus on investments in the local South African hedge and long only industry. My role is Chief Investment Officer.

Matthias Knab

I just read the Novare Hedge Fund Report that said assets are up 8% in South Africa, it is now, 32.1 billion Rand and 12 new funds were formed in the last 12 months. What will impact the further growth of assets and the hedge fund industry here?

Leila Kuhlenthal

In the local hedge fund industry where pension funds account for most of the assets under management (either through fund-of-hedge-funds or directly), we have needed clarity surrounding Regulation 28 which governs the assets South African pension funds can invest in. The second draft of this regulation was circulated on 2 December 2010 and it looks positive. Until we had this, I did not expect to see significant flows into the industry from traditional sources.

Regarding the Novare Investments survey, I believe that the 8% also include performance, which means that the increase from new inflows was less than this.

James Gilfillan

I believe, going forward, future growth for the South African hedge fund industry could be enhanced if the foreign emerging market flows touch the local hedge industry. Our local hedge industry offers a very attractive proposition and I believe we can compete favorably with other hedge fund jurisdictions in terms of return generation, risk management, independence, transparency, custodianship, liquidity, combined with sophisticated prime brokerage, derivatives and script lending capabilities.

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James Gilfillan

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Ian Hamilton

One of the things that have restricted our whole industry over the last eight years or since inception has been the regulatory framework. South Africa does not have regulated structures that foreign investors can invest in; we are still hampered on that particular point. That is unlikely to change in the immediate future as the Financial Services Board (FSB) has indicated that there will only be consultation next year, which may lead to possible regulated structures in 2012.

The other issue is Regulation 28 of the Pension Funds Act. The Regulation 28 proposals that have been tabled for final comment in January 2011 have taken most of us by surprise and could be most beneficial for the domestic market in that the current limits have placed the retirement industry at a very low ceiling. The proposals effectively double if not triple the limits that pension funds can now invest up to. This not only will allow existing pension fund investors to increase their exposure but also encourage those funds who did not invest because the limits were so low as to not be a meaningful type of investment. There is also an acceptance of some of the current structures as suitable for retirement funds but I need more time to study the proposals before making a comment on this.

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It is unfortunate that hedge funds have been misunderstood in the domestic marketplace over the last year. Most markets witnessed a strong equity market performance, but few people, particularly trustees, actually understood that hedge funds did not collapse by 40% like normal equity funds.

Ian Hamilton

Once we have a regulated structure, these first two issues will fall away.

A third aspect is that we - by not having regulated structures in place in South Africa – operate Rand denominated funds because of currency controls in this country. This is really a prohibition against foreign investors to engage in the South African hedge fund market.

It is unfortunate that hedge funds have been misunderstood in the domestic marketplace over the last year. Most markets witnessed a strong equity market performance, but few people, particularly trustees, actually understood that hedge funds did not collapse by 40% like normal equity funds.

Leila Kuhlenthal

I agree with you Ian, and apart from the majority of our local equity hedge funds producing solid returns during the financial crisis, we have also witnessed the fixed income hedge funds coming into their own over the recent years. The fixed income hedge funds have by-and-large delivered stunning returns for their investors over the last year. For example, we have two fixed income strategies in the Peregrine stable both managed by Green Oak Capital: the Go Green and Green Oak Specialist funds. They are both relatively conservative in that they do not invest in any corporate or credit paper and the maximum historical leverage on the more aggressive strategy, Go Green is 7-10x. In reality though leverage has been only around 2-3x this year and they have still managed to deliver after fee returns of 28.4% and 19.3% year-to-date end October 2010. Could this be an additional part of the local investment spectrum that trustees are possibly overlooking?

Murray Todd

So in a nutshell, there are three potential areas that may unlock flows. One, the international investors potentially - I think we have got a good relative track record especially in dollars versus international hedge funds. Two, from high net worth individuals, but we don't really have a large store of private wealth in SA, unlike Switzerland. Finally, regulatory consistency and an understanding of what is required to give comfort to regulatory bodies concerning hedge funds in South Africa.

James Gilfillan

Of a universe of approximately 156 funds (data taken from the Africa hedge fund survey), there were 66 single hedge managers, 26 African managers, and 44 fund of hedge. More than 90% of those managers beat cash over the last 12 months, with most doing far better, with extremely high percentage positive month statistics, i.e. predictability. And remember, we are talking about South African cash yields here, 7-10% over the period. Secondly, only 9 out of those had negative numbers. All this data refers to the 12 months to the end of September 2010.

Secondly, the World Economic Forum's Global Competitiveness Report, which had 159 participants, ranked South Africa as number one in the strength of auditing and reporting standards. In the regulation of securities exchange, South Africa is also number one. Compare this to India, China, Turkey, Russia, and all the other emerging market players. Again, out of 159 countries, in the strength of investor protection, we are number ten, and in soundness of banking system, number six.

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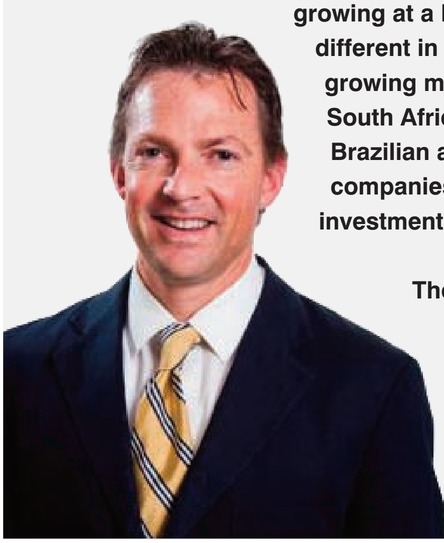
Let me also address an argument people sometimes bring forth when discussing the South African investment case. The argument for choosing an alternative emerging market over South Africa might be that the GDP of South Africa is growing at a lower rate relative to many other emerging markets. While that is true, what is different in South Africa is that the earnings growth of the companies here are actually growing much faster than in places like Brazil, i.e. the earnings growth is not tied only by South Africa's GDP growth, but by Africa's and China's growth. As a starting point, the Brazilian and South African current PE's are very similar, but the earnings growth of the companies that are listed in South Africa tends to be faster, making it a compelling investment destination.



There seems to be a disconnect between people's perception about the South African lack of productivity and GDP growth being slow, while the actual performance of the underlying listed companies that people use in hedge funds and in normal investing in the African context, is very appealing. The African and China growth story is embedded in the South African listed company story.

James Gilfillan

Investors will first look at return data and then decide whether to hedge or not to hedge currency. They look at the quality of transparency and risk management here, things like independence and liquidity. Taking all of that into account, it doesn't seem to me to be a hard decision as a foreigner to use South African vehicles as a way to access Africa, particularly if from a macro level, investors understand how to manage currency.

As we know, many of the other emerging market absolute solutions don't have the ability to hedge currency or the markets.

Let me also address an argument people sometimes bring forth when discussing the South African investment case. The argument for choosing an alternative emerging market over South Africa might be that the GDP of South Africa is growing at a lower rate relative to many other emerging markets. While that is true, what is different in South Africa is that the earnings growth of the companies here are actually growing much faster than in places like Brazil, i.e. the earnings growth is not tied only by South Africa's GDP growth, but by Africa's and China's growth. As a starting point, the Brazilian and South African current PE's are very similar, but the earnings growth of the companies that are listed in South Africa tends to be faster, making it a compelling investment destination.

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These perception gaps seem to persist, and as we discussed the outlook for the industry has got a lot to do with whether or not foreigners decide to look for Alpha using hedge funds in South Africa. At the moment, South Africa hedge fund managers are regulated, but their products are not. What is interesting is that despite regulatory hurdles and perception problems facing the global hedge fund industry, a huge institutional entity, like CALPERS, the large Californian pension fund, has managed to overcome those hurdles and had made meaningful allocations to hedge funds. Why not in South Africa? Foreigner investors might wake up before local institutions do?

Norman Au

When Investec did a Cap Intro tour last year, taking South African hedge fund managers to the UK and introducing them to investors, many of them were impressed and started to seriously consider an allocation. However the relatively small size of South African hedge funds turned out to be an obstacle. The investors were prepared to invest significant amounts in the funds, but due to the relative size of the existing funds, the amounts investable would have increased the size of the funds by multiples.

Leila Kuhlenthal

I have heard offshore investors confirm what Norman has highlighted. Recently I was discussing the investment opportunities available in South Africa with an offshore fund-of-hedge-fund manager and they said that they know of only five South African single manager hedge funds that they would be able to invest in given their restrictions on being no more than a certain percentage of any fund manager's AUM. Any manager with less than R1 billion under management is simply not feasible for them. They have nonetheless been invested in the local hedge fund industry for over seven years now. Fortunately we are able to count one of the largest and longest running South African hedge funds in our stable, Peregrine Capital which was founded by Clive Nates and David Fraser in 1998. Currently they have R2.8bn under management and advise on a further R400m.

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Leila Kuhlenthal

Ian Hamilton

Ian Hamilton: I agree. The small fund size is a major problem in going to market overseas. On our Lions of Africa platform we are now up to a $100 million. We do see now a lot more interest coming from foreign investors, but even $20-50 million would be equivalent to 50% of the assets of a fund. While investors do not particularly like it from that point, they are still considering these funds.

Matthias Knab

Can you maybe explain the concept the Lions of Africa?

Ian Hamilton

Lions of Africa is an investment platform where South African fund managers can replicate their local portfolios offshore in a Dollar denominated vehicle outside of South African currency controls. Our vehicles are structures that are well understood by foreign investors, they offer the same protections they are used to, and they don't have to worry about the currency hedging.

Matthias Knab **Are you using Cayman hedge fund structures?**

Ian Hamilton Lions is a Cayman hedge fund structure but is considering a move to Malta or setting up mirror funds so as to be within the EU.

But apart from the asset size issue, managers from places like South Africa also have to be aware they compete with quite a number of fund managers that are sitting in London or the States investing into Africa. They may invest into the same regions, but the big difference is they are very close to their audiences – the international investor base.

South African fund managers tend to travel to a place like London, sometimes without an adequate structure, talk and then they are never seen again, not understanding the longer term relationship build-up you need to have with your investors.

On the other hand, as I said, a manager sitting in London is going to walk around the corner to the funds of funds, and the institutions, and will receive investors who fly in. This is what South African fund managers must realize.

Then of course the question comes up if South Africa hedge funds should be run from South Africa or from a place like London? How will the performance differ?

Leila Kuhlenthal One option is for a fund manager to have offices in different locations but obviously costs then become a consideration. The fund managers of the Big Rock Capital strategy, for example, are globally-based but this move was not due to investor relations considerations. They recognized the importance of having some of the team on the ground in South Africa, especially for execution, and therefore two of the five investment professionals are in South Africa; the remaining three are in New Zealand and Australia. This works well for them as one of the main advantages being across time zones (apart from the mitigation of business continuity risk) is that their portfolio has coverage 24 hours a day, 5 days a week. There are not too many funds that can say this. Before the South Africa markets have opened, the New Zealand/Australian based team has done a full analysis of the previous day's close and completed their research for the current trading day. Ideas are discussed in an online team meeting during South African early morning. There is then overlap between the two teams until midday in South Africa when the local team takes over completely.

Murray Todd A couple of observations about the discussion from my side:

Investors who look at South Africa or the African continent often start with an "interest allocation". If they buy into the African growth story, they could go into less liquid African markets in the long-only format and then use hedge in the more developed African markets like South Africa, where there is greater sophistication of instruments. But, we believe that if they are looking to buy the growth story, they are going to go long-only African equities.

In our experience, most emerging market investors come in and out quite quickly. It is typically quite hot money. If things don't move in 6 or 8 months, they are gone. I am not sure if this is the type of money that the local hedge fund industry should be looking to attract and whether for international investors it is the right approach, given the opportunities and circumstances in Africa at the moment that require a medium to long term time horizon.

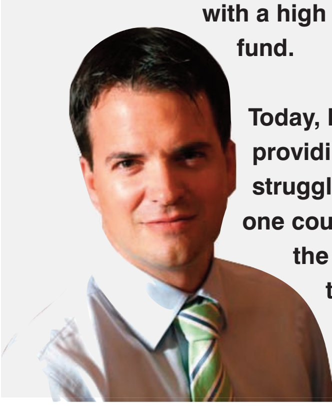
Investors have become enormously fee sensitive. Historically in the offshore hedge fund world, investors were used to paying 2 and 20. We now find that they do not pay that anymore without very good reason. Investors today want to know what they are paying for, and why they are paying for it. We talk about hurdles in South Africa whereas international investors talk about a preferred rate of return - they are essentially the same tool.

A further observation about local hedge fund managers is that many of them do not understand how important distribution is. They tend to rely heavily on the local allocators of capital, which in this case in South Africa are the local funds of funds. The funds of funds basically serve as a single manager's distribution arm. If they are not included in the funds of fund's product line, growing assets will be incredibly difficult.

The South African investor landscape is fragmented into high net worth clients and institutional pension funds, with the institutions being the main drivers of capital in the market, which is why we have transparency, liquidity and all of those good things. However, at the moment many of the pension funds are cash flow negative. They manage their assets and liabilities according to their income/expense stream and when they come to an asset manager they have to have a clear idea of what they need from that specific allocation. They are looking for a solution that fits their situation, therefore looking forward the fund of funds are competing more and more on a solution-based approach and not a one size fits all product.

This dynamic has further ramifications, because now investors want to see an underlying manager's performance against a pre-defined and measurable benchmark.

If you go back five or ten years, the first hedge funds were launched here by very talented people with a more generalist approach. They have now grown into larger funds, and have gone through the full market cycle. This could entail that sometimes they will have had more market neutral exposure, and on other occasions they would have been more directional. The problem is that given this new investor paradigm, investors and their consultants want to know, with a high degree of certainty, what is going to happen in terms of the performance of that specific fund.



Today, hedge funds that do not differentiate themselves with a very clear idea of what they are providing are going to struggle. If they don't have distribution on top of that, they are going to really struggle. If I look at a market neutral fund that offers cash +4 or +5 versus a long/short fund where one could have -5 to +30, when creating a solution for an ultimate client one would tend to select the fund where there is more certainty of return. It is not, per se a question of the returns themselves.

Murray Todd

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select the fund where there is more certainty of return. It is not, per se a question of the returns themselves.

James Gilfillan The liquidity issue or lack thereof is often raised regarding offshore investment into the local hedge industry. It seems that the long only foreign investors have been able to overcome this hurdle, so one could deduce that they would be able to do so in the hedge industry. This issue was raised when the industry size used to be R3 billion, now at R31 billion, it is still raised. Demand tends to expand liquidity.

Talking about fee compression, it appears that the best global managers such as Caxton, Brevan Howard etc. seem to be able to continue to attract significant inflows, now, post the crisis and without fee compression. As always, it is the net result that counts. Typical single manager hedge funds in South Africa charge 1% management fee and 20% performance fee above a substantial cash hurdle. This is low compared to the Caxtons, Moore Global's of the world.

Leila Kuhlenthal In terms of capital raising, the first step for most local fund managers is to start onshore, build up the necessary critical asset mass with local investors and then move to the next stage which is attracting offshore capital. I think this is where a handful of South African hedge fund managers are now. This goes back to our earlier point of size being most of our local fund managers' largest hindrance to raising offshore capital as offshore institutional investors, such as the funds-of-hedge-funds, generally have limits as to the percentage of a single manager's assets they can represent. To overcome this, one would need to find those offshore investors willing to provide initial capital into a fund as part of a possible seeding program for example.

Nonetheless, not all South African hedge fund managers have their size as an issue as there are those with over R1bn under management; moreover there are also those investors who do not have limitations on their allocations. The point is just that there are fewer of both and those investors who would like exposure to South African hedge funds will need to capture the available capacity while it still exists of those managers that are of sufficient size.

Murray Todd Is it not a case of critical mass? Until you reach a certain size, offshore investors are not going to take you seriously.

James Gilfillan On the subject of South African Hedge fund liquidity, many foreign investors are starting to invest in various long only African funds and liquidity is far worse in some of those markets. Currencies in those funds also present significant challenges. Again, South Africa provides very useful access to Africa, by virtue of the fact that many of the listed companies are growing their businesses successfully in the rest of Africa.

On the subject of South African Hedge fund liquidity, many foreign investors are starting to invest in various long only African funds and liquidity is far worse in some of those markets. Currencies in those funds also present significant challenges. Again, South Africa provides very useful access to Africa, by virtue of the fact that many of the listed companies are growing their businesses successfully in the rest of Africa.

Our understanding is that while local South Africans are often reticent about investing in their own country, the Chinese are busy buying African arable land and resources. They are running around the continent buying whole regions, while the rest of the world keeps its distance.

My point here is that there is no reason why there shouldn't be a value proposition for South Africa or the rest of Africa or the combination of both. With the right educational process of interaction between the foreigners and the local hedge industry, things should move into the right direction.

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Matthias Knab **James, you brought up the word perception gap - what do people miss when they look at South Africa or Africa?**

James Gilfillan For example, this just happened with the World Cup. We, South Africans, and perhaps many in other African countries thought or were stuck in the paradigm that we would not be able to produce a successful world cup. Yet, we had infrastructure, we had all of the systems and people to allow that to actually happen. There was simply a large perception gap.

We, South Africans, and perhaps many in other African countries thought or were stuck in the paradigm that we would not be able to produce a successful world cup. Yet, we had infrastructure, we had all of the systems and people to allow that to actually happen. There was simply a large perception gap.

Similarly, most foreign visitors are reluctant to travel to South Africa, because of crime statistics. Yet, the Soccer World Cup brought visitors who had a unique and fabulous holiday. In the same way, in my view, the hedge fund industry in South Africa is in the top decile in the world in terms of its returns, quality, people, systems, processes, transparency or whatever you want to use as a criteria.

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Coming back to the World Cup, probably quite a few people thought that South Africa was a place they would never visit, but the event ended up changing the perception completely about what the country offers and what the risk-reward is here.

Leila Kuhlenthal I can appreciate what you are saying James about the South African hedge fund industry being world class and the erroneous assumption to those outside the industry that it may fall short of international standards. I experienced this myself after I returned to South Africa in July 2009 after having spent a year in Singapore and six years in the City of London. When I returned and joined the Peregrine group in October 2009, I was indeed impressed by the local industry's reporting standards, disclosure of information, and the extensive use of independent service providers. The fee structures are also competitive with the majority of funds, especially equity market neutral, making use of a hurdle rate with performance fees only being earned above the hurdle.

In terms of reporting standards and disclosure of information, internationally it has historically not been common practice to provide investors with daily mandate compliance & risk reports, or daily NAVs. In South Africa, through a prime-broker such as Peregrine Prime, an investor can receive daily reporting customized to his/her needs subject to fund manager agreement even when investing in a pooled fund. No fund manager that I have come across locally has so far refused such an investor request. A second differentiator is access to the senior portfolio managers. Internationally, you often only manage to speak to the Investor Relations person – in South Africa, the founder of the business is generally happy to speak to the investors directly.

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Leila Kuhlenthal

In conclusion and back to James's point, the local hedge funds seem to be in-line and even ahead in some instances compared to their international peers and communicating this message to the international community should be the focus.

Ian Hamilton But still, when compared to international hedge funds, it seems most of our hedge fund firms here are maybe too small. Should we not be looking at amalgamations, things like joint ventures, mergers or partnerships?

Leila Kuhlenthal Maybe that is the answer Ian, to partner with firms who do have that scale, who can provide those other services like distribution, operations and so forth. We have recognized that need and provide an array of non-investment related services to those hedge funds that we partner with through the Peregrine Fund Platform so that the hedge fund managers can focus on what they do best which is generating returns for their investors.

Murray Todd Leila mentioned our fees here being very competitive, which I think is correct. However, in our industry where the pension funds are the big allocators, you are ultimately a fee taker. When you compare the total expense for the hedge funds and fund of funds to some of the other products, then some pension funds may say "listen, the fees are just not worth it".

Leila Kuhlenthal Of course Murray, investors certainly need to look at the fees charged and satisfy themselves that they are commensurate with the fund manager skill they are purchasing but one should not lose sight of the fact that it is the after fees returns which are most important and going back to James's point raised earlier, there are those international funds on fee structures north of 2% and 25% who continue to raise significant capital because their net returns are very compelling. It is often a case of needing to pay for quality with those fund managers with above average fee scales generally producing above average after fee returns. Data provider Hedge Fund Research demonstrated just this in a report published in November 2009.

Murray Todd I take your point about paying peanuts and getting monkeys. But you have got to look at the environment that we are in. For instance, why should a market neutral fund be taking performance fees on their cash? Why should the less liquid funds have short crystallization periods? Those are the types of issues we need to talk about as an industry.

The management fee should cover operating expenses and fairly remunerate a team. But the management fee should not be the reason to run a fund as one simply becomes an asset gatherer. The performance fee should be the incentive to perform and participate in that performance. But it has to be structured very carefully to ensure that the correct behavior is encouraged.

Matthias Knab **What would be the fee restructure that you think would serve that purpose?**

Murray Todd It depends on a number of different issues. It depends on the type of strategy, the size of assets required, the size of the team that you need to effectively run that strategy. It depends on a number of things, there is no one size that fits all.

Tony Christien Are we perhaps then looking at a situation where the performance fee and the hurdles specific to that performance fee should be structured more accurately around the strategy that the fund is actually running, as opposed to merely taking steady plus 2 or whatever that might be. We certainly see it from our side and have noted a move by managers to link their hurdles a lot closer to the types of strategies that they are dealing with.

Murray Todd Yes, that is exactly what I am saying. One needs to have very specialised managers with a very clear expectation of what the outcomes are going to be and the way you incentivise them is going to be critical to achieve that.

Matthias Knab **Where are opportunities in Africa and South Africa from an investment point of view? What is your outlook?**

James Gilfillan A hedge fund manager prepared me a couple of interesting statistics just on Africa.

- 60% of the world's total amount of uncultivated arable land is in Africa, just to start off with.
- $1.6 trillion is Africa's collective GDP in dollars in 2008, which is roughly equal to Brazil's.
- There are 52 cities in Africa with more than a million people.
- In 2008, African consumers spent $860 billion.
- 1.1 billion Africans will be of working age in 2040.

Since the year 2000, 316 million new mobile phone subscribers signed up in Africa.

The point being you have a youngish population demographic, a resource base that is clearly attractive and of course all the other problems exist. In a survey on political issues, rule of law etc. are typically high in people's perceptions. The reality is that in all emerging markets, eg. Brazil, India, the issues raised about Africa regarding respect for land ownership, the rule of law, etc. are no different than those raised about any of the other emerging markets.

The Africa story is pretty compelling from an emerging market growth story, not just because of South Africa, but because of its youth, we are a world resource bank, because of our land and rivers. Most of Africa's rivers are clean, whereas in most of the countries that have been industrialized, they have rather unclean rivers. There are many reasons why the story is pretty good for the Africa, and yet, the story is relatively untouched and undiscovered, except by the East at the moment.

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James Gilfillan

Money has started to pour in from the east where they have recognized the 100-year picture and they are allocating capital with a long view. That must mean that someone of reasonable consideration, who thinks about capital allocation in terms of the resources is seeing something that many are not.

Let me give you an example. I was in London with a private equity specialist who told me that the new legislation in South African around wind and power generation has meant that his fund – a private equity fund with a 10-15 year horizon - is currently buying up tracts of land in this country, Mozambique and all along the West Coast. Most locals do not even know that this is happening - this is a London-based professional with a global picture who is allocating capital in the Southern African region.

Murray Todd

James has very eloquently put forward the case for Africa. We would go further when presenting to current and potential clients.

When you consider the austerity measures coming through in Europe, coupled with the recent QE2 announcement in the U.S., then investors must start looking for real growth assets. The first places that they have gone to are the emerging markets, the BRIC countries. However, the valuations there are beginning to look frothy, they are not cheap anymore.

If you are looking for growth at a reasonable price, your cost per unit of growth in Africa is far less demanding than it is in Asia or China. In addition to that, it is an alternative way to play the China growth story at a far less demanding entry price. Africa will benefit from FDI flows from China as they try to access the resources in the ground and build the required infrastructure. The give-up for the "growth at a reasonable price" is the current limited liquidity in African markets. We believe that this too will improve over time.

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Murray Todd

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There are different ways to access Africa - the listed space, private equity and the mezzanine space. You are beginning to see a real interest in Africa as evidenced by the number of brokerage reports being written. Goldman Sachs' Jim O'Neill has just released a report. It discusses the "Next 11" emerging markets which include Nigeria and Egypt. McKinsey just wrote a great report. All of these reports, written by people and institutions with real gravitas, are starting to come across the desks of international allocators on a far more regular basis. The increase in awareness and interest in Africa is incredible.

When the All Seasons Africa Fund was launched in early 2008, there were probably 20 Africa funds in existence. Only 8 or 10 were sufficiently robust in terms of best practice and independent administration. If you count the Africa funds now, you will probably find about 80 to 100 funds managing Africa money in various strategies.

Norman Au

At the recent Hedge Funds World conference in Cape Town, Teresa Barger, CEO of Cartica Capital, spoke about being cautious when investing in Africa, being street wise and having some common sense. We should take note of the issues she warned us about at the conference... We, at Investec, have been researching on some of the companies in these African Exchanges (like the food companies in the Nigeria) for our clients and potential clients. On a recent road show to the UK and USA, there was enormous interest in African companies. Some of the things and traps Teresa spoke about in terms of even the parallel bookkeeping, the accounting, need to be queried and challenged.

Ian Hamilton

Norman, with respect, if you look at people who have been pouring into China, investing in China - also Chinese bookkeeping has been something else, and a lot of people have burnt their fingers going in to China from that...

Murray Todd

40-50% of the FDI coming into Africa is Chinese driven.

China presents Africa with three key advantages. It has got capital that it is prepared to put in. It has got a real urgency to place that capital and it is going to make infrastructural improvements that will allow Africa to leapfrog its development over the next couple of years: highways, railroads, bridges, dams, telecom infrastructure etc.

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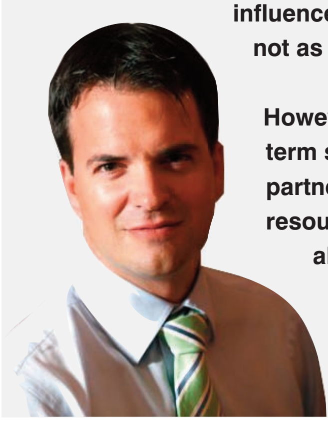
On the negative side, some of the infrastructure build is not of the best quality, there are rumors of undue political influence (but this is not just particular to China) and their approach to human resources is probably not as onerous as some other countries.



However, China has identified the need for resources. Their centralized government, with its long-term solutions based approach, is offering African countries a number of flexible options to partnership in terms of infrastructural spend and cheap borrowings. African countries with resources will need to ensure that they get the best possible deal in terms of not just price but also the development of local industries, like developing their beneficiation abilities, education, transfer of skills etc.

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It's worth noting that George Bush was instrumental in assisting Africa by pushing the debt forgiveness program. Debt, as a percentage of GDP was approximately 70%, 10 years ago. As a result of the debt forgiveness initiative (HIPC) and Gleneagles, a substantial portion of that debt was written off by the World Bank and IMF. This has resulted in current debt to GDP ratios of closer to 30%, which is an enormous advantage for an emerging market. It's a real game changer.

Ian Hamilton I think one of the dangers is that China will do it in their way, which is fine The West just sits back and whines that China is not playing fair. Everything the West does has to be now supremely politically correct when dealing with Third World countries. Political correctness is not something that you are going to find in the Chinese dictionaries.

Murray Todd Will China bid up the prices?

Ian Hamilton Well, I believe China will bid up the prices of the resources and take them away from the Western world.

Murray Todd In order to give light to it, look at the oil fields outside Nigeria or Ghana or mineral resources in other African countries being bid up. We think that it is a very positive development for Africa as the increased global interest allows them to be price setters rather than takers.

Leila Kuhlenthal Perhaps you are right Murray or, as mentioned in one of the presentations at the Hedge Funds World Africa 2010 conference, perhaps the West can see what is happening, but it isn't able to do anything about it? My question is then "how can the South African hedge fund managers take advantage of the rest of the African story while sticking to their mandates of liquidity and pricing and importantly would their investors like them to?" Of course, they can obtain access via the African gateway stocks such as Shoprite, MTN and Standard Bank but they may not be able to participate beyond the South African borders without changing their mandate terms or offering a new fund on different terms.

James Gilfillan The way to play it, and this is the beauty of seeing South Africa not as just a resource play only, which is also the perception gap, but a hedge fund manager here can utilize his access points in liquid counters, long and short, and get access to what is happening in the growth rate of Africa. Shoprite, the listed South African food retailer has a significant footprint in Africa and an investment in its South African listing provides an African story. Walmart has just acquired Massmart, another listed South African retailer because of its potential growth in Africa. These are liquid counters and due to the efficiency of the South African markets, hedge fund managers can pro-actively risk manage with shorts in less attractive interest rate sensitive counters.

Ian Hamilton To follow up on that, I don't believe that we have any hedge funds here in South Africa industry that are actually dedicated to minerals and metals. This really amazes overseas investors who think that minerals and metals is all they would be getting out of this country.

Leila Kuhlenthal You have a point Ian. I know several relatively large local hedge funds whose allocations to resources are surprising small and don't view this as the sector from which most of their alpha should be generated.

Murray Todd From our perspective we do not want the local managers to have exposure to Africa, except through a separate dedicated Africa fund. While there will always be an exposure to Africa through stocks like Shoprite, Standard, Massmart etc., we would ensure that there are very clear, mandated guidelines to managing SA monies because our performance is measured locally. One also has to consider the clients' need for compliance with Regulation 28.

Ian Hamilton The other thing is that pension funds in South Africa are allowed to invest a further 5% of their assets into Africa excluding South Africa. Also from that point of view you cannot mix the two at all, as it could actually diminish the amount that could be allocated to the local funds.

Matthias Knab **We always discussed here Africa, South Africa in the context of emerging markets. If we look at emerging markets, the universe stretches from places like China, India, Vietnam, Taiwan to say Peru, Chile, and Brazil - where does Africa and South Africa fit in? What is special about your continent, what should investors know?**

James Gilfillan Again, having been to Chile, having spent some time in South America, having lived in New York, in my opinion South Africa should rank very highly within the global hedge fund industries, not only in regard to hedge fund infrastructure specifically, but also in terms of market dynamics. There is a statistic out there that shows that over the past 100 years, the South African stock market is among the top three performers of any world market in US dollars.

Ian Hamilton If you look at the bigger global picture and think about where Europe and the U.S. are heading with their financial infrastructural problems, debt crisis, austerity, fear of double dip, risk of social unrest and all those kind of issues, I don't hear anyone talking about heavy recessions or anything like that in Africa and South Africa. We are still talking about a sustained growth.

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Ian Hamilton

Leila Kuhlenthal It is undisputable that money is flowing into South Africa. The question is rather, what percentage of this is flowing into South African hedge funds? Since I joined the Peregrine group in October 2009, I have seen a noticeable increase in the number of requests for information from investors based in the United Kingdom and Europe. I am also aware of a recent $35 million allocation into two or three local single managers. What has been the take-up on your offshore platform Ian?

Ian Hamilton Patrice Moyal, the major fund manager on the Lions of Africa platform has recently been on a road show overseas. He has come back extremely positive as to what the take-up is going to be. But there is another issue and that is American investors have their own set of restrictions when it comes to offshore funds, so the take up is from Europe.

Murray Todd Setting up robust U.S. structures is both time consuming and costly and there is still no guarantee that the monies will flow. But, if you don't have the structures in place allocators won't even look at investing. You have to fish in the deep sea to catch the big fish.

Matthias Knab **Each year the South African hedge fund industry gets more mature and investors have more choices. Can you update us what funds have been formed recently? Do new strategies become available? James, your firm also engages in seeding hedge fund managers – do you want to add some details here?**

James Gilfillan A successful hedge fund model globally is possibly one of the best margin businesses. Therefore, it is always going to attract investment specialists who can muster the combined intellectual strength and tenacity and discipline to actually end up thriving.

In South Africa, there are let us say 70-100 managers in teams of three to four. So, that means the universe is 300-400 people who are skilled in the area of making decisions around hedge strategies as a start.

In terms of new funds, I think new funds are always being developed. The only reason that we have seeded a few managers is because you meet a fantastic practitioner, and there is no avenue for those people to access capital and there is no framework in the local infrastructure and no way for them to gain assets.

So, the talent pool and the environment for seeding is good, there is plenty of skill out there. We have forged in the fixed income space, for example, which was not even on the radar four to five years ago and now it is central to allocations. The local fixed interest managers have made money in rising interest rate environments and declining interest rate environments. So, if the question is, is there a universe that is attractive? I think so. Could it grow a lot? I think so. Are there lots of new potential managers? Definitely.

Tony Christien If we look at the funds on the IDS fund administration platform, we have noted some 30 new fund formations versus 15 to 20 closures over the past 12 months or so. A lot of those closures were smaller managers who could not attract capital, but on a net base we have had a positive growth in fund numbers.

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It is also interesting from where the new managers are coming from. This year I have personally seen and dealt with about 10 managers. Some of them came from existing houses and others relocated back to South Africa from overseas.

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It is also interesting from where the new managers are coming from. This year I have personally seen and dealt with about 10 managers. Some of them came from existing houses and others relocated back to South Africa from overseas.

Obviously, it has become more onerous to start a new hedge fund firm. From 2005 to 2007, it could happen that a multi-manager engages with a new manager, saying "this is the guy we want to seed", giving them say 50 million, and within a space of two week the fund is up and running. Today, and one of the reasons is that cash is harder to come by, it is taking anywhere from 3 to 6 months to go through all the hoops and get the commitment.

Ian Hamilton

I do think that one of the problems that new fund managers encounter when coming out of an institution or returning from working overseas is the difficulty in getting the approved licenses from the Financial Services Board. It is not that there is anything wrong with these fund managers but usually difficulties are based on simple misunderstandings regarding their qualifications by the Financial Services Board.

Leila Kuhlenthal

With regard to new strategy types entering the South African hedge fund market, it was exciting to see one or two young systematic strategies present at our annual Peregrine Securities Investor Open Day in November 2010. We were pleased to be able to assist these funds in show-casing themselves and raising their profile with the ultimate aim of facilitating their capital raising. This further widens the investable universe for allocators providing opportunities for uncorrelated alpha sources.

Matthias Knab

Should Africa funds be run out of Africa, or can this also be done out of London and New York?

Murray Todd

18 months ago we would have said definitely not and that African managers must be based in Africa. However, after visiting managers in the US and London I have done a 180 degree turn and I think that they can quite successfully manage money sitting outside of Africa. Some of them have been managing very successful Africa Funds since the early 1990's. However, the big caveat is that they must build and maintain an informational advantage.

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If a manager is prepared to travel 30% - 40% of their time in Africa - great. If they are prepared to have a desk that trades during the African trading hours – great. If they are prepared to spend a significant portion of their time developing and maintaining their network in Africa – great.

From our point of view, it does not matter where they sit, as long as they have access to a network of information that allows them to make good investment decisions and react to timely information flows decisively. An African manager has to be on the ground and kicking the tires to make sure that he is not invested in counters that have parallel companies or that are fiddling with the accounts.

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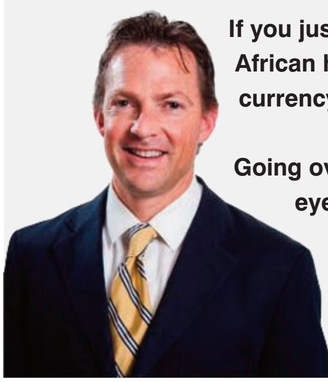
Matthias Knab **Before we close, can we briefly speak about the returns of the South African hedge funds?**

James Gilfillan If you just glance your eyes down the fixed income single manager hedge fund returns in South African hedge fund database - 12 month returns stand at 76%, 43%, 23% - this is in local rand currency - 15%, 15%, 13%, 46%, 14%, 26%, 11%, 14%.

Going over the fund of funds return over the last 12 months - there are 44 fund of funds - and run your eye down the statistics, the numbers are like 20%, 11%, 18%, 12%, 17%, 15%, 14%, 13%, 13%, 9%, 16%. These are respectable returns. Noteworthy is that in 2008, a large proportion of the single managers actually made gains. Those figures compare favorably to the international figures, much better with no hedged currency, but still competitive after currency hedging.



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