OPALESQUE

# Opalesque Round Table Series '11

# SOUTH AFRICA

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# Editor’s Note

**The rich opportunity sets in Africa cannot be overlooked**

South Africa counts around 135 domestic hedge fund management companies, predominantly within three strategies: equity long/short, market neutral and fixed income arbitrage. Over the past years, this highly qualified group of hedge fund managers has consistently outperformed the global and domestic markets, as well as their global hedge fund peers. Until October 2011, the South Africa single manager composite index is up over 7%, while the JSE all-share index was flat and MSCI Emerging Market Index lost almost 13%.

New access vehicles like the Nautilus Management Account Platform, which is **the only managed account platform in the world owned by a stock exchange**, make it now even easier for international investors to access South African hedge funds.

From a regulatory perspective, South Africa is surprisingly a couple of steps ahead of most other jurisdictions, as it has a stringent regulations of managers in place and recently, with the important **Pension Regulation 28, has now also validated hedge funds as eligible asset class for longterm investment.** Before Reg 28, hedge funds were considered an unlisted security and the total exposure was limited to 2.5%. That definition as unlisted has been removed and the threshold has been lifted up to a total of 10% that can be allocated to hedge funds.

**South African pensions earmark significant funds for Pan Africa funds**

The aforementioned Regulation 28 also allows an additional 5% of South African pension assets to be invested into Africa. As a consequence, a lot of highly skilled South African fund managers are looking up north into Africa in order to capture both the investment opportunities and the asset flows. South African institutions will move several billion dollars lines into Africa over the next few years, resulting in significant inflows for the managers dedicated to this region. The rich opportunity sets in Africa cannot be overlooked.

**Africa’s evolution as investment destination**

Africa’s roots lies in its debt markets. Investment banks have been originating and funding deals, and sometimes debt issues may be offered to the market on the back of those. Debt markets therefore dominate a number of African financial markets. The next evolutionary development involved moving down the capital structure as private equity players introduced mezzanine or convertible debt financing and pure private equity players emerged. The private equity deals were done primarily on the back of funding from the development agencies, and the subsequent roll out private equity type vehicles into the African market.

The next evolutionary step will be the further development of equity financing, which should enhance the depth and liquidity of listed equity markets on the continent and further allow international investors to participate in the Africa story.

The Opalesque 2011 South Africa was sponsored by IDS Group and took place in November at their office in Cape Town. We also thank Roundtable Series sponsor Custom House Group for their continued support. The participants:

1. **Alexia Kobusch,** Head of Risk, Nautilus Managed Account Platform
2. **André Steyn,** CEO, Steyn Capital Management
3. **Bilal Haffejee,** Head Fixed Income Prime Broking at Rand Merchant Bank
4. **Bradley Anthony,** Head of Distribution & Product Strategy, Fairtree Capital
5. **Francois Cilliers,** CIO, Novare Investments
6. **Ian Hamilton,** Chief Executive Officer, Investment Data Services Group

also discuss:

- **What to consider when investing on African exchanges that are not recognized by the World Federation of Exchanges**
- **Why licensing a hedge fund in South Africa can be more onerous than with the U.K. FSA**
- **Strong corporate governance: literally all South African hedge funds have third party administration, third party custody, compliance consultants, risk monitoring, strong auditors and offer transparency with daily look through into their portfolios together with detailed risk reports**
- **Why a fund manager would want to domicile a South African orientated fund rather in Malta and not in Cayman**
- **How to assemble a portfolio of high quality African companies with an average return on invested capital of 46%**
- **Strategies how to make money in Africa beyond commodities**

Welcome to South Africa!
Matthias Knab
Director Opalesque
knab@opalesque.com

Cover Photo: Johannesburg Skyline

# Participant Profiles

(LEFT TO RIGHT)

Alexia Kobusch, Ian Hamilton, Bilal Haffejee, André Steyn, Francois Cilliers, Bradley Anthony, Matthias Knab

# Who we are and what we do?

The IDS Group is an independent fund administration group which was founded in 2002. We specialize 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 works 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.

**When should you consider using IDS Group services?**

Whether you’re looking to launch a new fund, make a transition to a new administrator or simply wish to outsource some of your processes, we have a solution to suit your needs.

# Introduction

**Ian Hamilton**
IDS Group

My name is Ian Hamilton, I am the head of IDS Group, which is one of Africa's, if not Africa's leading alternative investment administration company. Despite the different more difficult times, we are still seeing a growth in our asset base through South Africa and also internationally through our Malta operation. We are very much Africa-focused, so the investments that we are administering are mostly African, and it is very encouraging to see that there is slow, but continued interest from the international markets into Africa-orientated type of funds.

But I really think that looking at the times, I would like to quote Dickens at this stage and that is from the opening of *The Tale of Two Cities* and I think it is very appropriate to all of us. And it opens with, *"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of Hope, it was the winter of Despair, we had everything before us, we had nothing before us, we were all going direct to Heaven, we were all going direct the other way,"* and that is really where we are sitting in both local and also in the international markets. It is not just *A Tale of Two Cities*, it is a tale of two continents that is happening right now.

**André Steyn**
Steyn Capital Management

I am André Steyn, Portfolio Manager at Steyn Capital Management, an alternative investment firm focused on Africa. We currently manage two funds, a long/short fund investing in South African equities as well as a recently launched Pan Africa fund. Our longest running fund has compounded at a net 29.7% in US dollars since inception in May 2009. The fund was awarded Fund of the Year in both South Africa and Africa in 2010, and was nominated for awards in 2009 and 2011.

**Bradley Anthony**
Fairtree Capital

My name is Bradley Anthony and I represent Fairtree Capital, a leading boutique fund management business based in Cape Town, South Africa. Our heritage lies primarily in relative value equity hedge fund management. Our flagship market neutral fund has an eight-year track record, compounding at 15% net per annum, and we've expanded the product range over the years to include long short equity, fixed income, Africa and commodities. Today, we manage about $250 million in assets across these different asset classes, regions and strategies, including a limited range of long-only mandates.

**Alexia Kobusch**
Nautilus Management Account Platform

I am Alexia Kobusch. I run the Nautilus Management Account Platform, which is the only managed account platform in the world owned by a stock exchange. We launched four years ago under the FirstRand Stable and as of July 1 this year, we fall under the Johannesburg Stock Exchange (JSE). We like to see ourselves as a facilitator for all stakeholders in the industry and aim to improve the quality and integrity of the hedge fund sector and finally to positively affect the perception of the hedge fund asset class for regulators.

**Francois Cilliers**
Novare Investments

My name is Francois Cilliers. I am the CIO of Novare Investments, a member company of the Novare Holdings Group, with total client assets of around $4 billion. I am here today representing the fund of hedge funds division of the investment business, in particular the Mayibentsha Fund of Funds, which had its inception in 2003 and was one of the fund of hedge fund pioneers in the South African industry. Novare Investments also produces a pre-eminent – annual survey on the South African hedge fund market, Interested parties are welcome to obtain from our website, www.novare.com.

**Bilal Haffejee**
Rand Merchant Bank

I am Bilal Haffejee from Rand Merchant Bank prime broking. We are a division of FirstRand Bank Limited which is one of South Africa's four major banking groups. The Prime Broking business offers a multi asset class solution across both the equities and fixed income asset classes which leverages off the balance sheet of the FirstRand Group.

**Matthias Knab** **What are some of the recent developments in South Africa that are relevant for international investors?**

**Alexia Kobusch: We have seen that some international investors are only willing to invest into hedge funds that are run through managed account platforms, because of the concerns around the operational risks of investing into a hedge fund. We have 34 hedge funds on our platform and a track record in terms of what we do, so for international investors it will be important knowing that we offer that conduit for them to invest into local South African quality funds.**

**At the moment, our end investors are retail, high net worth individuals, pensions and fund of funds. At some point we will also expand beyond just South African hedge funds.**

**Ian Hamilton** Does your managed account platform offer assistance to South African hedge funds for marketing them overseas?

**Alexia Kobusch** We will be doing our own international road shows. We would anticipate that the fund managers will go overseas as well and market themselves. I see this as a joint effort.

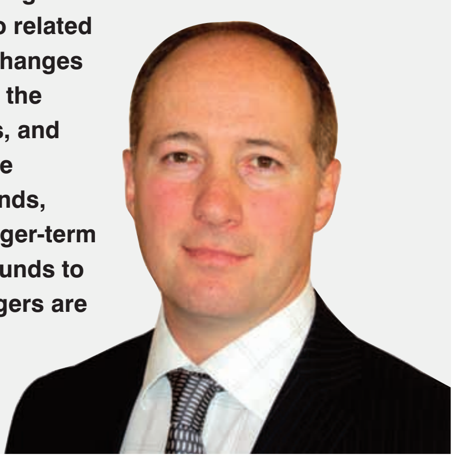
**Matthias Knab** **Do you offer also dollar hedging and foreign currency accounts, or is it all in South African Rand?**

**Alexia Kobusch** Currently we are only in South African Rands, but we are looking at duplicating our structure offshore which will be dollar based.

**André Steyn** I think replication of your managed account platform overseas would be a great idea. What I find as a manager, and as somebody who previously worked both in New York and London, is that in general South African hedge funds are too small to attract substantial inflows from overseas investors. Your platform could be help alleviate this problem for both overseas investors and local funds.

**As for other significant developments, I see a big, exciting move where the local hedge fund managers have started to look northwards; that is they are looking into Africa. Two related factors are behind this development. Everyone at the table here knows about the changes in the pension fund regulations (the so-called Regulation 28), which has increased the amount that pension funds can invest into hedge funds from 2.5% to 10% of assets, and which now allows an additional 5% of assets to be invested into Africa. While these changes may limit in the short-term some investments into South African hedge funds, because some pension funds had already exceeded the 10% upper limit, in the longer-term it will be positive. In addition, Reg 28 has opened up another avenue for pension funds to invest in Africa. As a consequence, a lot of highly skilled South African fund managers are looking up into Africa in order to capture both those opportunities and those asset flows.**

**André Steyn**

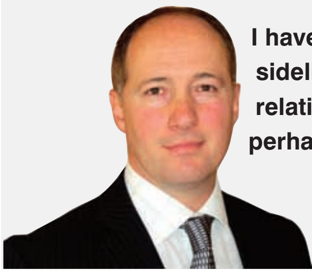


**Bradley Anthony** I agree in principle, however, Regulation 28 is fairly restrictive in that it stipulates that African investments will only be recognized for South African pension funds for investments on recognized stock exchanges or full members of the Federation of Exchanges, which limits things slightly. If you look at the attractiveness of markets up north, the second largest market in Africa is Nigeria, however Nigeria is not one of those recognized stock exchanges. So, how do you capture this great growth opportunity when you are limited to Morocco, Egypt, Mauritius, and South Africa?

**André Steyn**

The main focus of our fund is to seek out and exploit market inefficiencies. In my view, it is highly probable that large amounts of money will flow into Africa over the next few years, partially as a result of the changes in Reg 28, which will help raise asset prices. The fact that South African pension money won't be flowing into some of the market like Nigeria will not negate the overall impact on many of the markets.

Of course, there is a second aspect, more from a marketing angle, which is how to capture the flows from these pension funds. One thing a fund manager could do may be to set up two fund structures, one investing on recognized exchanges only and the second fund being more liberal. However, that is not our plan at this point. We seek to profit from inefficiencies, not participate in creating them!



**I have spoken with South African institutions and I know there are several billion dollars on the sidelines that want to move into Africa over the next few years. If you look at those future inflows in relation to the African investment universe, you will find about 50 fund managers in Africa that perhaps manage $5 or $6 billion. That means we are talking about a significant amount of inflows.**

**André Steyn**

**Bradley Anthony**

We have a two-and-a-half year track record with our Africa fund, which is probably more suited to foreign investors for this reason. Another approach may be to differentiate products for foreign investors versus South African investors. I think there is a greater opportunity set to exploit the Africa opportunity for foreign investors who do not have the kind of restrictions that South African pension funds have. At this point in time, we are definitely focused on exploiting the entire opportunity set across the continent.

**Ian Hamilton**

When it comes to hedge funds and African investments, Reg 28 does not include a look-through into offshore funds that are investing into those markets. So, as long as a particular offshore fund manages those investments and recognizes those particular markets, there seems to be satisfaction with the regulator about the question around recognized African stock exchanges. Only if a South African fund manager invests directly the assets of a South African fund on not recognized African exchanges, that issue arises.

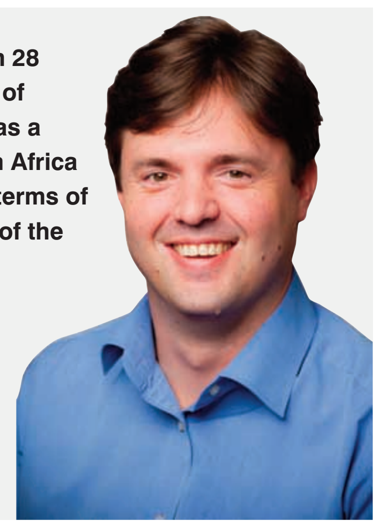
**Bradley Anthony**

I think there are issues around Reg 28 which may still need to be clarified. My understanding is that the National Treasury needs to put out a directive with regards to offshore versus local exposures for pension funds, despite the lack of look through principle for hedge funds.

**Francois Cilliers: One of the most important positive effects of our recent local Regulation 28 amendment, which does not directly impact offshore investors however, is that this piece of important pension fund legislation has recognized and I believe legitimized hedge funds as a potentially valuable long-term investment for local pension fund investors. Here in South Africa at the moment, hedge fund managers are already regulated, which is an advancement in terms of regulation which I know our offshore and overseas peers are still grappling with in terms of the creation of an overall suitable regulatory framework for hedge fund managers.**

**I believe it is important to point out in this regard that the South African market is surprisingly a couple of steps ahead in terms of both what is already in place, pertaining to manager regulation, as well as validating hedge funds as eligible asset class for long-term investment.**

**Francois Cilliers**



**André Steyn:** Before setting up my hedge fund here in South Africa, I worked for a U.S. SEC registered hedge fund in New York and then for a U.K. FSA authorized hedge fund in London. I was pleasantly surprised to see that the structures being used here were from an investor's point of view absolutely world class. Almost all fund have very strong third party administration, which is an absolute must, third party custody, compliance consultants, risk monitoring, and strong auditors.

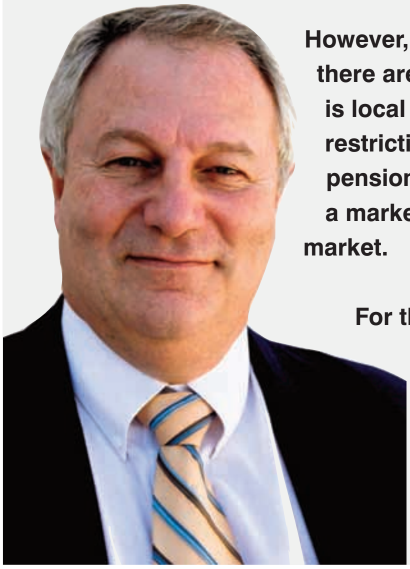
As Francois pointed out, in addition the managers are licensed by the Financial Services Board (FSB). While getting our firm authorized by the FSA in London probably took about two or three weeks and involved a couple of signatures on my part as the CEO of the company, I found the process here far more onerous with numerous checks by the local regulator. Investors should welcome this extra measure of protection.

**Bilal Haffejee:** In addition, hedge fund managers in the South African market give their investors a lot of transparency - there is daily look through into their portfolios together with detailed risk reports. Alexia's managed account platform, for example, performs daily mandates compliance and reporting. All in all, the practices in the South African hedge fund industry should give foreign investors a lot of comfort.

Bilal Haffejee

**Ian Hamilton** Let me add a bit more details about Regulation 28, because when we talk to particularly foreign investors we often feel it is important to explain exactly what it is.

Reg 28 defines which asset classes South African pensions can go into. Before Reg 28, hedge funds were considered an unlisted security and the total exposure was limited to 2.5%. That definition as unlisted has been removed and the threshold has been lifted up to a total of 10% that can be allocated to hedge funds. What is actually very rewarding for the industry was the recognition that despite not being a regulated product, hedge funds should be included in pension fund portfolios. The recognition from the South African Treasury acknowledges that the South African Hedge fund industry is an industry that has been very responsible, and as mentioned earlier, has all the checks and balances in place, which affords the protection for the institutional investors and particularly the pension funds.



However, so far we have not seen a huge rush from the pension funds into hedge funds, I think there are two reasons for that. One factor is that anything that looks a hedge fund, whether it is local or overseas - there was quite a large overseas exposure - falls into the 10% restriction. The other aspect, which I actually find encouraging for our industry, is that pensions are an institutional market. They therefore don't make quick decisions to rush into a market, and that at the same time they do not make a quick decision to leave a particular market.

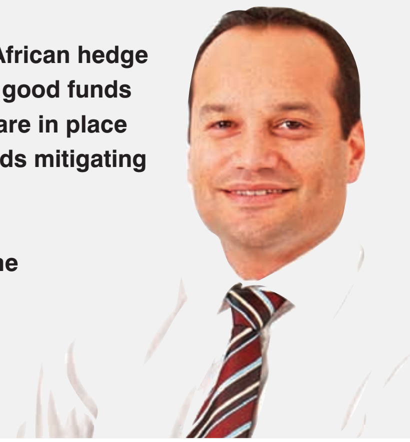
For that reason we have not seen really big fluctuations in assets in the South African Hedge fund industry as in other countries where hedge funds were also sold to the man on the street who can make snap decisions the moment he reads something negative about the hedge fund market. We have been very well protected by having serious investors.

Ian Hamilton

**Bradley Anthony: I have often heard that international investors do not want to come into South African hedge funds, because they have a limit of being no more than 10% of a particular fund. The average South African hedge fund is considered too small for them to accommodate their typical ticket size.**

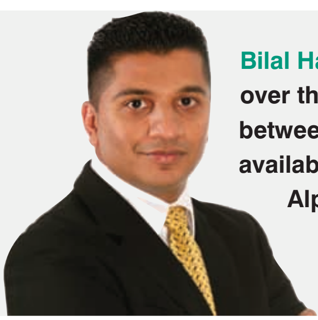
**However, the reality is that roughly 70% of the 30 odd billion rand in the South African hedge fund industry is managed by 20% of the hedge fund managers. There are some good funds out there with sufficient size and capacity. In addition, we have structures that are in place like Alexia's managed account platform that, hopefully, will go a long way towards mitigating the problem of investor concentration.**

**Our markets are fairly deep and liquid. We have a fairly liquid equity market - the equities market cap turns over 40 times a year, and the fixed income market is probably a lot more liquid than that, so liquidity in our market is not a major problem.**



**Bradley Anthony**

South African hedge funds can very easily double in size from a capacity and liquidity perspective. Of course, certain hedge fund strategies may play in a less liquid space and may have some restrictions, but, again, investors who do the work and find those "institutional grade" hedge funds which do have capacity and are large and liquid, will find sufficient exciting opportunities in the South African market. As mentioned previously, our firm currently manages in the region of $250million and has capacity to manage probably double that amount. Further, because of our scale, we have the ability to enhance capacity by carefully growing the business, which is a strategic imperative at the moment.



**Bilal Haffejee: The assets under management in fixed income hedge funds have practically doubled over the last few years, and the funds are still able to maintain fantastic returns which have been between 10% annualized going up all the way close to 40%. There are a number of strategies available to fixed income hedge funds, and through these managers are able to generate fantastic Alpha.**

**Ian Hamilton** Just a question more on the fixed interest side, because this is one area that we are not able to replicate overseas. This is due to certain specific structures that we have here on the fixed interest market and the different parties investing there. Would you be able to elaborate if there is a way for foreign investors to come into the funds, because unfortunately we do not have regulated structures foreign investors can come into. All our structures in fixed income and fixed interest are Rand denominated. Are there any moves to actually make fixed interest funds, that have been one of our growth areas, more available to the foreign investor?

**Bilal Haffejee** Just to make sure I am understanding your question correctly – are you asking if there are moves to make foreign currency fixed income funds available to foreign investors? The exchange control regulations in South Africa prohibit South Africa banks specifically from doing that, but managers are able to set up an offshore structure and use an international prime broker to do this. When foreign investors invest directly into South African fixed income funds who play the local market, there is the additional exchange control restriction that foreign investments not make up more than 75% of the funds assets under management. At this point the legal status of the fund changes and the margining arrangements for over the counter (OTC) transactions with the fund would have to be different.

**Ian Hamilton** For years, foreign investors wanted to invest directly into our local hedge fund market, and I believe it has done us a lot of damage that we have not able to accommodate this. We need to point out to the foreign investors what area they can go into and what they can't do. I believe our industry should continue to address this issue.

**Alexia Kobusch:** **We definitely see that international investors see South African markets or African markets in general as a growth opportunity. We are interested in helping those investors get better access to the local markets which so far are restricted by Exchange Control (Excon) and certain tax implications for consumers.**

**We spoke to one of the top lawyers in South Africa to determine whether investing through our managed account platform would be punitive to offshore investors. We can state based on legal opinion that there would be no withholding tax for offshore investors who use our platform to invest locally. They would be subject to the same rules that a local investor, so they would have to demonstrate whether it would be capital or revenue in nature, and that could be based on intent, and that in turn would be based on how long they hold their investments. Depending on the domicile of the investor, they might be taxed in their local jurisdiction or there might be a double tax agreement in place.**

**We are not offering advice in respect of their home jurisdiction, but definitely here in the local market international investors would be treated like a local investor. From an Exchange Control point of view, if they wanted to take their money out, they would be allowed as long as their initial investment used the correct channels.**

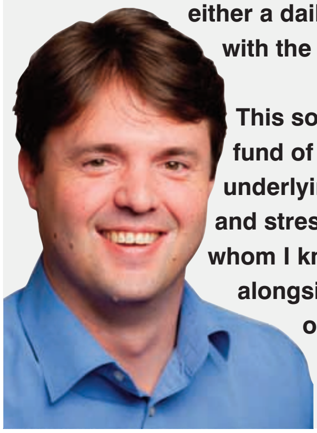
**We believe this is a very exciting opportunity for international investors to get access to very high quality of South African managers. I have seen a lot of offshore funds. I believe the local fund managers are solid and that there is a great degree of responsibility and integrity in our fund managers that does not always exist in the international arena.**

**Alexia Kobusch**

**Matthias Knab** **Can you explain us how you work with transparency here in South Africa?**

**Francois Cilliers:** **One of the primary challenges in the industry, going back a few years now when I was still working for a fund of hedge funds abroad, was the issue of how much underlying portfolio transparency was desirable and importantly, what are you actually able to do with that transparency. The entire argument of how greater transparency was desirable and the resultant question of what fund of hedge funds actually ended up doing with it responsibly formed the basis for this to-and-fro dialogue or argument between hedge funds and their fund of fund or investor counterparts.**

**Given that the local market tackled this issue head-on while it was still in its nascence, some of the more pro-active local fund of hedge funds have established sensible methods of how to uniformly and seamlessly aggregate complete underlying manager holdings level data into their reporting. This happens directly from prime broker level access, on either a daily or weekly basis, which allows for risk aggregation and reporting at fund of funds level, but with the appropriate anonymity pertaining to individual manager positions or holdings.**



**This solution also allows a fund of funds to perform its own daily mandate checks at manager and the fund of funds level. In practice, this means that some fund of funds can account for their complete underlying fund holdings at stock or sector level daily, as well as doing risk monitoring, management and stress testing on their entire data series. This contrasts with the majority of overseas players whom I know, back then at least, often still merely collated their underlying managers' top 10 holdings alongside the gross and net exposures of their funds. Kudos to those local players in terms of not only setting, but implementing the appropriate standards here domestically in a meaningful manner.**

**Francois Cilliers**

**Matthias Knab** **At Novare, do you invest in South African funds only or also into global hedge funds?**

**Francois Cilliers** Given the current limitations by both the local Reserve Bank as well as the regulatory limits on offshore investments applicable to local investors, the opportunities for investing into offshore hedge funds are rather limited. Local investors are of course allowed to directly invest or utilize their offshore capacity in whichever way they deem most appropriate, however I would strongly suspect that most domestic investors would again be inclined to do so via a fund of funds, and then again via a house-name with whom they are familiar or through whom they have gained the requisite comfort.

**Matthias Knab** **At this point in time, what are the vehicles through which international investors can access South African hedge funds?**

**Alexia Kobusch** Our managed account platform can accommodate foreign investors. I do not know what the other vehicles are...

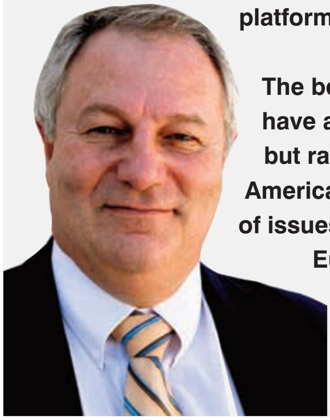
**Ian Hamilton: There are quite a few international platforms that actually replicate the portfolio that are on offer here in South Africa. Some of those platforms have been running for quite some time. We administer one of them, it has around $150 million of investments and has been operational for five years. This platform has a well-established footprint into the European investor market. One of the questions we are looking at now is if the funds need to be within the European domicile, meaning they may have to be relocated from Cayman or other offshore jurisdictions into Europe, so that they are more accessible for the European investor.**

Ian Hamilton

**Matthias Knab** **Do you offer onshore and offshore platforms?**

**Ian Hamilton: We have two vehicles. One is a Malta based vehicle, the Knights of Malta platform, and we have a second vehicle, a platform based in Cayman.**

**I think it is an interesting debate to have as to which vehicle investors prefer. We cannot answer this categorically, but the sense we have is that U.S. investors would prefer a Cayman based vehicle, while the European investors may not prefer a Cayman based vehicle. I think it is probably wise and prudent for managers to explore multiple platforms or jurisdictions for their funds.**



**The best experience that we have actually had and the only reason that you would actually want to have a South African orientated fund in Malta and not in Cayman has nothing to do with marketing, but rather double taxation. We also advise fund managers with Cayman funds serving the American market rather to maintain their Cayman fund and not re-domicile, because there are a lot of issues that affect the investors. The only reason why people want to re-domicile is to market into Europe, which is in the interest of the fund manager and the fund management firm, but not in the interest of the investor, so we strongly advise against that.**

Ian Hamilton

**Matthias Knab** **What are some of the opportunities you see right now or mid term in the markets?**

**Francois Cilliers** I think there has been an enormous amount of talk around global investors looking for emerging market or BRICS exposure, where South Africa should arguably be featuring as the "S" within BRICS, both by conventional wisdom as well as given that it is by far the largest and most liquid listed market within Africa. Given the backdrop of global market turmoil in recent years however, these flows materialized more slowly than one would have anticipated. The opportunity however remains a very substantive one and once markets stabilize, I think there will be a renewed search for growth, which will again renew the focus on more stable and liquid emerging markets, including South Africa.

In the short-term however, the South African hedge fund industry has been pretty much stagnant in terms of asset growth – over the 2010 to 2011 period the market neither grew nor shrank materially and remained stable at around R31bn-R32bn in terms of AUM. Our challenge remains how to bring about making the substantive leap in marketing South Africa as a destination with world class investment and hedge fund expertise, which should then see this asset base grow to be much more representative of its rightful contributor to local market capitalization. There is no reason why local hedge fund assets could not grow to be well in excess of R100bn or R150bn.

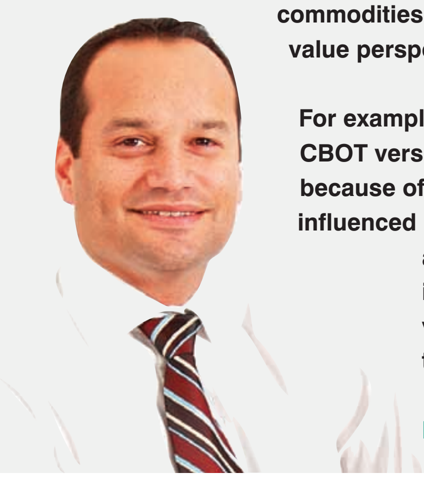
**Bradley Anthony: We see two answers to that. There seems to be a focus on allocating capital to where the better growth opportunities are, and that is the BRICS story we talked about earlier. As a fund manager, you definitely need to create products which will tap into that. You need to have products which will tap into the growth opportunities north of the South African border – Sub-Saharan or Pan African funds offer opportunity sets which cannot be overlooked. The same applies to a certain extent to the South African market which, relative to developed markets, offers potentially greater growth opportunities.**

**There is another opportunity which is less often talked about: the relative value opportunity set which is available in a number of different asset classes in the emerging markets, South Africa and Africa being one of them. If you look at global hedge fund performance in 2011, especially in the equity relative value space, funds have struggled. Globally statistical arbitrage and equity market neutral managers have battled with increased correlation and record low dispersion.**

**In the South African equity market there has been a sufficient amount of dispersion, albeit at multi-year lows, to extract value out of relative value trading. At the same time, the relative value opportunity set in fixed income has been tremendous in South Africa, and the outlook continues to look fairly attractive. We have a fixed income relative value fund annualizing over 20% net per annum in Rands, which for us seems a decent enough opportunity set at relatively low risk.**

**Another opportunity set which should not be overlooked is in the soft commodity space. Commodity price drivers include not only Chinese growth, but also the developing food scarcity and security theme, which is influenced by issues such as demographics, climate change, etc. There is an opportunity from a growth perspective to play the commodities theme, but as I said before there is an equally appealing opportunity from a relative value perspective.**

**For example, our commodities team may trade relative value between U.S. corn prices listed on CBOT versus South African maize prices listed on SAFEX. There are plenty of those trades because of subtleties in the commodities market, where the supply-demand dynamic is influenced by participants with insulated perspectives, such as farmers, food producers, banks and financial market participants. Actual consumption demand further influences import or export agendas. I therefore believe we shouldn't overlook the relative value proposition, as it offers attractive risk adjusted returns to fund management teams skilled in the asset class.**



**Bradley Anthony**

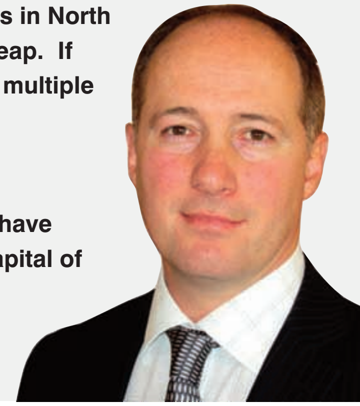
**André Steyn**

In my view, the two main opportunities right now for foreign investors looking into Africa is firstly to access world class hedge fund manager skills within South Africa, and secondly to use managers ferreting out market inefficiencies across Africa.

**André Steyn: As Bradley accurately pointed out, a lot of our managers run uncorrelated strategies and extract relative value. The proof is in the numbers, with the South African hedge fund index up 7.2% year-to-date versus the Dow Jones Emerging Market Hedge Fund index down 1.9%.**

**Within Africa itself, there is much less opportunity to short, impeding relative value strategies. Here, managers need to be able to identify and exploit undervalued market anomalies. As a result of revolutions in North Africa and fiscal imprudence in east Africa, the market is now in my opinion extremely cheap. If you look across the market of 750 non-financial companies, the average pre-tax earnings multiple is eight times, one-third of all banks are trading below ten times earnings, and half of the insurance companies in Africa are trading below tangible book value.**

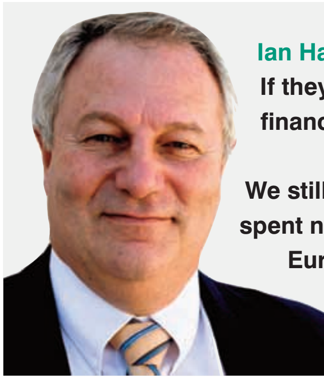
**Africa is home to a tremendous number of very high quality companies. For example, we have managed to assemble a portfolio of 20 or so names with an average return on invested capital of 46%. These are not numbers that you would easily find in more developed markets.**



André Steyn

**Bilal Haffejee**

In a sense, the world economy and the impact that it has on the South African economy creates trading opportunities for the skilled managers based here. At the start of the year, the question being asked in the local markets was when will the reserve bank start hiking interest rates, and the way that things have panned out is that there will in all likelihood be a further drop in interest rates. The volatility available in the market creates opportunities for fund managers who use their skill to extract brilliant alpha for their investors.



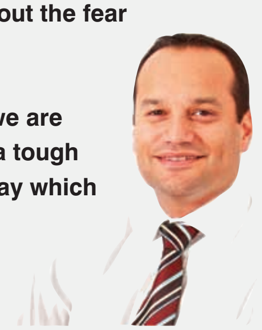
**Ian Hamilton: Compared to the banks overseas, our banks here do not have an exposure to Europe. If they are exposed, it will be very limited and mostly via a totally separate entity offshore. Our financial system here is very strong and stable.**

**We still have relatively low personal debt, despite the Minister of Finance remarking that everybody spent next year's salary already, but compared to other international markets - the Americans and Europeans – this level of consumer debt is not that significant. That means that even on the consumer side, we still have capacity for growth despite a slowdown and the economic pressures that are happening around the world.**

**Bradley Anthony: People should also take a deeper look not only at our market structure or regulation, but also the response of the regulators through the 2008 crises.**

**At no stage were we considering short selling bans, and at no stage were our banks in severe distress. Our markets have sufficient volatility to create valuation and price anomalies, but investors can rely on the stability of the financial system and the regulatory framework that actually allows you to exploit those opportunities without the fear that the game is going to be changed while you invest. That in itself is a huge opportunity.**

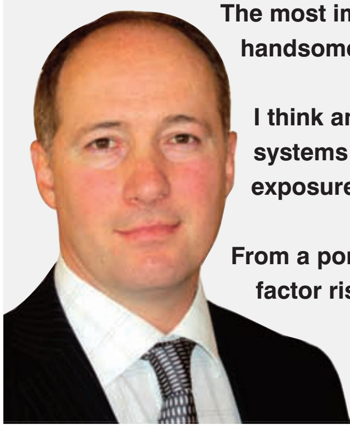
**We are all based here, so we are well aware of the opportunities in Africa and South Africa, but we are forced to de-prioritize them when Europe is having its problems and the world is going through a tough time. However, the African theme is not going to change. There is a demographic dynamic at play which is going to see Africa emerge. While there are short-term wobbles to which we are not immune, the growth story in Africa will ensure that it continues to emerge as a leading investment destination.**



Bradley Anthony

**Alexia Kobusch** I have got a question for André and for Bradley in terms of investing into Africa. My biggest concerns are political risk and the safety of your assets. When you invest in exchanges that are not recognized by the World Federation of Exchanges, how do you address the question around the safety of your assets and how are you mitigating the political risk, or are you ignoring it completely?

**André Steyn: You bring up both operational and political risk. The operational risk is non-negotiable: we only invest through counterparties which we have vetted, and all of our assets are held by global custodians.**



**The most important mitigant to political risk, which is of course only one factor risk, is to be handsomely compensated for bearing it.**

**I think anyone who tells you they have an edge in evaluating the 20 or so relatively unstable political systems in Africa is delusional. The key is to, a) get paid for it, and b) avoid or greatly limit exposure to political systems where a likely outcome is a complete loss of investment.**

**From a portfolio point of view, a manager should ensure not have too much exposure to any one factor risk, be that political, FX, commodity, interest rate, or industry concentration.**

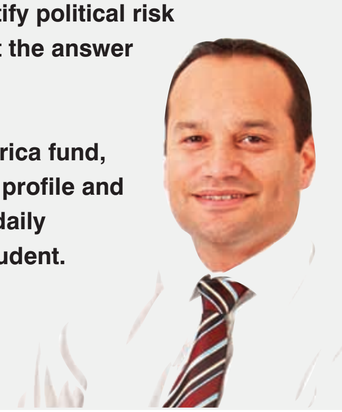
**André Steyn**

**Bradley Anthony** I could not agree more. Often people forget that investment management is about assuming risk. You need to be able to identify the risk, quantify the risk, and then assume the risk with the right compensation to the investor.

**Ian Hamilton** Since about five years we have started to work with Mauritius as a financial hub. Their system is reasonably stable with a good banking system that actually is well spread into Africa. The custody is operational, though maybe not in the full conventional sense we are used to in the past and over here, but it actually works very well.

**Bradley Anthony: I noticed that we speak about hedge funds and Pan-Africa or Sub-Saharan Africa funds as if they are homogenous, but a lot of distinctions need to be made here. By way of example, our risk appetite at Fairtree may be very different to André's risk appetite. We have certain filters which we apply, to identify political risk or liquidity risk, whatever the case may be and I am sure André does similar work, but the answer that we come to is different.**

**For that reason, I think investors need to be savvy and aware when allocating to an Africa fund, understanding the risk profile of a fund manager so that they can marry it to their risk profile and liquidity. Talking about liquidity, I once heard of an Africa fund that was running with daily liquidity. Now, that is just silly and for investors to invest in such a fund is really imprudent. Investors need to marry their risk profile, liquidity profile and investment horizon with what that fund manager is doing.**



**Bradley Anthony**

**Ian Hamilton** Bradley has hit on a very important point. We have actually turned away business in our Malta operation from people who wanted to set up UCITS funds to invest into Africa. We advised them on liquidity, and we believe that there are unfortunately some issues with that for someone who suggests to run an UCITS type structure for a Pan African fund. I have actually found one or two from a particular investment house, which makes me believe there is a certain amount of smoke and mirrors in those funds...

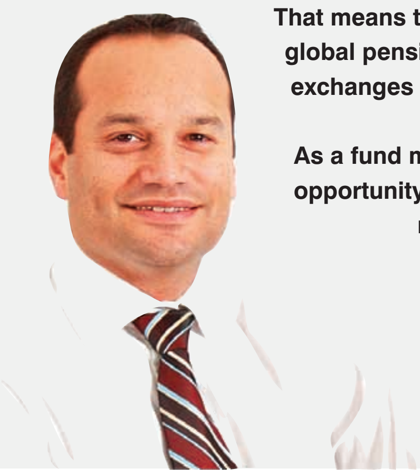
**Matthias Knab** **How has the African continent ex-South Africa evolved as an investment destination in terms of available vehicles, instruments, exchanges, companies - how is the whole financial infrastructure, the investable infrastructure evolving?**

**Bradley Anthony:** Africa's heritage lies in its debt markets. African markets have really been about debt origination and financing. Investment banks have been originating and funding deals, and sometimes debt issues may be offered to the market on the back of those. Debt markets therefore dominate a number of African financial markets.

Therefore, our roots can be found in debt markets. The next evolutionary development involved moving down the capital structure as private equity players introduced mezzanine or convertible debt financing and pure private equity players emerged. The private equity deals were done primarily on the back of funding from the development agencies, and the subsequent roll out private equity type vehicles into the African market. We think the next evolutionary step will be the further development of equity financing, which should enhance the depth and liquidity of listed equity markets on the continent. Although it would be foolish to expect that this happens overnight.

Here are some current numbers that exemplify where we are at the moment:

- Nigeria has got about 200 companies listed on their stock exchange with a market cap of $54 billion.
- Mauritius has got 87 companies with $6 billion market cap.
- Zimbabwe is 86 companies with about $4 billion market cap.
- Egypt is 200 companies with about $80 billion market cap.



That means there is a decent enough opportunity set, but it is not robust enough for the large global pension funds and institutional investors to play the Africa story through African exchanges alone.

As a fund manager, we need to think about how one can best capitalize on the Africa opportunity through equity securities of stocks and companies who derive the bulk of their revenue out of Africa. So, if we are smart and do our homework and start exploring the globe for listed companies who participate in the Africa story, you find you can exploit those opportunities through stocks listed in Toronto, London, Singapore, Australia etc. as well. This considerably broadens your universe, while the African continent itself continues to improve its depth as an equity destination as well.

Bradley Anthony

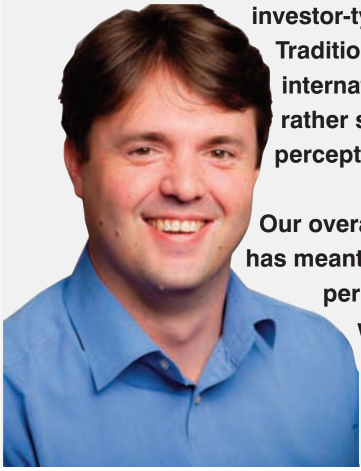
**André Steyn:** We see things changing in the right direction. For example, corporate governance is improving. We have an analyst that extracts source information from financial statements of all 1,000 listed African companies. With every new reporting period we can see both the timeous availability of data as well as general level of disclosure improving.

In Nigeria there is talk about potentially allowing to short stocks, which is interesting though not likely imminent. Many governments on the African continent are privatizing assets. As a fund manager, these are often the most interesting IPOs, because politicians will rarely sell a poor asset at an inflated price to their electorate.

André Steyn

**Matthias Knab** Let us talk about the Alpha in South Africa. Just looking at some statistics: while the JSE all-share index is down 7% and MSCI Emerging Market Index lost 23% until September 2011, the South Africa single manager composite index is up over 5% over the same time period. This is a clear Alpha that South African hedge fund managers are delivering. Where is this Alpha of the South African hedge fund managers coming from?

**Francois Cilliers:** I think it speaks to an earlier point which we mentioned, namely that the South African hedge fund market has structured itself by design to actually be rather conservative and to cater in the main for an institutional investor-type, rather than trying to cater for your higher risk or high net-worth individual investors. Traditionally, high net-worth investors make up a larger proportion of the investor base internationally than they do domestically. I believe this level of conservativeness, or I should rather say responsible and more stoic predictability, contrasts with the general and international perception of how risky some of the hedge fund strategies can potentially be.



Our overall more conservative DNA, accompanied by the best-practices which I mentioned earlier, has meant that hedge funds in aggregate domestically were better at protecting capital during periods of rather dramatic market downturns compared to both the JSE All Share Index, as well as broader emerging markets. This undoubtedly contributed to the outperformance you alluded to.

Francois Cilliers

**André Steyn:** Having invested in the US and Europe, I would add the South African market is less efficient than abroad, and hence it is perhaps slightly easier (though not easy!) to generate alpha. If you think you have a particular proprietary insight in South Africa, chances are you actually really do. In Europe or the U.S., you have 200 people looking at the same company which makes it so much harder. I believe this is a significant source of the alpha here.

André Steyn

**Alexia Kobusch:** What I find quite amusing is when speaking to fund managers, they all tell me that their strategy is relatively unique. Then I look at their portfolio and everybody else's portfolio, and I find they are all trading pretty much the same equities. However, their returns are significantly different, and I think what makes them good is the way in which they trade it.

If you look at their actual exposure, they look pretty similar across the board, but the important thing here is when they actually enter and exit those instruments. That makes all the difference. Some of these managers are really, really good traders. Some of them pick up on intraday trades. The optionality in how they put those trades on gives them their uniqueness while in the past, some managers' returns have been predominantly beta driven. They had not mastered their market.

The markets have been very ruthless in rooting out the guy that cannot trade properly, which is good for the investors because now they are paying fees to managers that actually deserve running their money.

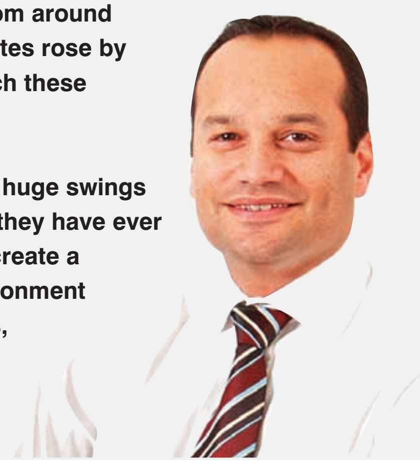
Alexia Kobusch

**Bradley Anthony:** **The returns of South African hedge funds are definitely positively skewed because of the conservative nature of our investors and managers. That implies a low degree of downside correlation with the market and a focus on capital preservation.**

**Having said that though, most managers do not necessarily correlate very highly on the upside either. If you look through the cycle, you will likely find that our managers' downside capital preservation mindsets tend to make the difference. Obviously there are mandates which capture upside, and they do it quite successfully, but I think our industry's conservative approach on the downside is probably what results in South African managers producing alpha over time.**

**I do not have empirical data to support this next concept; it's almost a philosophical thing or just plain opinion. Consider the volatility to which South African hedge fund managers, both in the fixed income and the equity space, have become accustomed. Let's look at fixed income; it's always an easier example to follow. In 1998, the South African Rand depreciated significantly, bond yields blew out from around about 12% to above 20% in the space of a few weeks, while short term policy rates rose by 700 basis points over 3 months. That is the kind of volatile environment in which these managers have grown up.**

**Most of us here have grown up in an environment where we got used to seeing huge swings in prices. I feel sorry for the Italian bond traders at the moment. I do not think they have ever seen yields move to the extent they have moved in this last period. That does create a different capacity to navigate volatile markets. If you have grown up in an environment where you are accustomed to these massive spikes in currencies, equity prices, and bonds yields, you are schooled in a different way.**



Bradley Anthony

**Ian Hamilton**

I just want to pick up on Bradley's comments about the Italian bond traders. In our Malta operation we find that our client base and our funds are very stable. Most of our clients there are Africa orientated and come from the South African background. Meanwhile we hear that competing fund administration firms experience that significant numbers of their funds are closing down. Many of them are not able to deal with the European volatility. I believe this is a feather in the South African cap. South African fund managers have been through such periods before and hence the local conservative approach.

**Matthias Knab**

**Let's look at the diversity and breadth of the South African hedge fund industry. Can you give us details on the make up of the industry here?**

**Francois Cilliers:** **We have about 130-135 domestic hedge funds, predominantly within three strategies: equity long/short, market neutral and fixed income arbitrage. Until about a year ago, market neutral funds and now more recently fixed income hedge funds have experienced good growth, given their ability to generate good returns in the varying market conditions, which Bilal also alluded to previously.**

Francois Cilliers

The primary allocators or access vehicles are still however fund of hedge funds, who have gone to the expense and effort to not only put in place the requisite infrastructure to properly research and monitory the local market, but also put together the teams who have dedicated themselves to understanding and evaluating the return-drivers of each of the strategies and funds domestically. It is a lot of work and here, like anywhere else in the world, you need to be on top of your game in order to be able to call yourself a custodian of hedge fund knowledge and understanding.

The predominant investor interest locally still seems to be coming from South African pension fund investors, who seem to clearly understand the value of holding hedge funds as a strategy in their portfolios and are therefore taking a long-term investment view by investing in them.

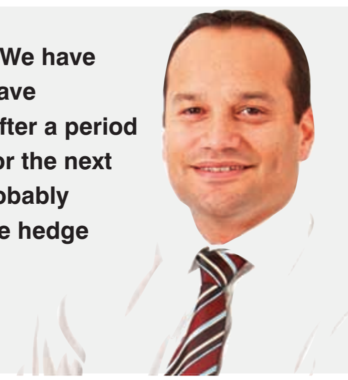
**Matthias Knab** **What are some of the developments regarding emerging or new managers setting up in South Africa?**

**Alexia Kobusch: Given the new FSB regulations, you need to have R3 million on your balance sheet in order to qualify for a Category 2A license, which allows you to start your fund (along with a host of other requirements that are more experience and qualification based). This is not an option for a lot of start-up fund managers as they do not have that kind of equity behind them.**

**We do see a lot of JVs being created between existing bigger asset management houses and start-ups that they incubate on their platform. It gives the new managers an opportunity to be associated with a credible house and at the same time get a track record going. Standalone fund launches are not as frequent because of the barriers to entry the regulations have put up effectively.**

**Bradley Anthony: I want to reflect for a moment on the evolution of the industry here. We have regulations for the hedge fund manager, and the pension fund regulations which we have discussed today have a substantial potential to increase the flows into the industry. After a period of fairly static AUM or lack of growth for the past four years, we are probably poised for the next growth phase. Looking forward two or three years down the road, the industry will probably experience decent growth. Right now, there are not very many large institutional grade hedge funds operating within Africa, but from an evolutionary perspective, that is probably where we are going.**

**Bradley Anthony**



If you look across the globe, you find large teams at big hedge fund houses running significant assets based on differentiated research platforms, operational infrastructure, deep pools of talent, IT infrastructure, compliance, and all of those things which you'd expect from a institutional fund management business. What will probably happen in the South African market is that where there is talent that wants to enter the market, there will probably be an entry point for that talent within the bigger houses which are wanting to acquire diversified skill-sets and strategies relative to their existing offerings.

So, I think the industry is either poised for consolidation of managers or for new managers to enter into existing houses, or a combination of the two. It is likely that we'll find a number of really big houses dominating the hedge fund landscape a couple of years down the road. There is no doubt an opportunity for smaller funds and smaller strategies, if people can meet the hurdles and barriers to entry into the industry, but the future of the industry lies in greater institutional capability, in our opinion.

**Alexia Kobusch** A lot of the large hedge funds are multi strategy hedge funds, which may pose a concern for the traditional fund of funds, because the multi-strategy funds can bring their offerings directly to the pension fund investors. The multi strategy funds will be starting to spend money to market themselves well, so probably the fund of funds need to up their game.

**Francois Cilliers**

I believe that anything which adds depth to the industry and increases overall asset size is highly beneficial, again for the industry as a whole. So at the end of the day I'm certain that all industry participants, and indeed fund of funds as well, will welcome any such positive development. There is of course the potential argument to be made for having an independent allocation to strategies as one has at a fund of funds level, which would otherwise reside within a single multi-strategy house and might lack proper independence, but we can leave that for a discussion for another time.

**Bradley Anthony**

I could not agree more. I think that there will always be a role for fund of funds in the South African market. Because of the complexity of the hedge fund industry, a number of South African pension funds have had no exposure at all to hedge funds. It is unrealistic to expect that those pension funds will go directly to single manager funds. They will always use a risk aggregator or risk manager such as a fund of hedge funds to go and seek out the best talent, and blend that talent in a way to create a stable risk-adjusted portfolio. Down the road there may be opportunities for single managers to make slight inroads into that market, but for a while the pension fund market will be dominated by the fund of funds.