

Investors upbeat on outlook for SA hedge funds – despite macro and geopolitical concerns and rising volatility

Respondents to this year's Investor Survey are more upbeat than ever about the outlook for the South African economy as well as for local hedge funds. That is in spite of a somewhat uncertain global macro and geopolitical outlook. Indeed, many anticipate rising volatility in markets – but see that as a potentially fertile environment for the hedge fund opportunity set.

In response to our annual questionnaire, every single investor – 100% – said they expected the industry to grow in the next year, the highest ever score on the survey. The proportion has been rising steadily from a minority of only 37.5% back in 2018 each year since then, but has never been totally unanimous before.

Respondents continue to believe the SA hedge fund sector has plenty of capacity to grow. And they expect the majority of growth in the coming year to come from retail investors, with over 80% expecting the new money to be invested via retail investor structures.

A significant minority of the investor sample – close to half – say they allocate to early-stage managers, and a significant and rising minority (36%) say they are now seeing sufficient new talent coming to the market.

Nevertheless, the respondents do not expect much, if any, of the new money coming in to the industry to be attracted to new manager launches, with over 90% expecting existing managers to get bigger instead. The majority of investors still believe high barriers to entry are inhibiting growth – although the proportion that take that view has fallen in the past four years to just under 64%.

A significant number of respondents (18%) still feel that fee levels are too high – and a majority of investors (63%) said that fees 'still need work'. A significant minority (36%) also feel that the interests of managers and investors are still not sufficiently aligned.

Over a quarter of the respondents (27%) confirmed they had exited some hedge fund investments in the past year – the highest level since 2019.



Elmien Wagenaar

Nevertheless, all the respondents were unanimous in the view that hedge funds are capable of meeting their stated objectives over the next 12 months.

Global macro factors in 2024 continue to affect prospects for investor portfolios. What is your global macro outlook at present? What can we expect from key global markets and economies?

As in previous surveys, there were a range of views from investor respondents about the macro outlook. These ranged from bullish – largely based on expectations that global interest rates are falling – to bearish, given fears about recession in the US, slow growth in China and geopolitical tensions including the wars in the Middle East and Ukraine. Either way, many anticipate higher volatility.

Elmien Wagenaar, investment manager at THINK.CAPITAL, said: "Globally, the past two interest-rate lowering cycles were as a result of crises – 2008 with the global financial crisis and 2020 as a result of Covid. Also, the 2008 cycle was so deep and so long that the way assets interacted arguably was assumed to be the norm. But this might be a mistake. We do not think the past 15 years were normal and we are of the opinion that as-

set-class returns will normalise, and that higher volatility should be expected."

François Cilliers, director of 2IP Investment Partners, agreed on the latter point, arguing: "Market volatility is likely to pick up again, both in the equity and bond markets, in the run-up to the US elections and as Fed rate decisions loom.

"Whereas valuations in the US remain stretched, SA, EM and other DMs still offer value," Cilliers added. "Hedge funds should be well suited to take advantage of the expected increase in market volatility."

Given Phaladi, CEO of Regive Capital, agreed that geopolitics and US elections will continue to create volatility in the market, thus creating market dislocations and opportunities. "The China recovery is very sticky, thus slowing demand for our minerals and in turn affecting our resources sector," he said.

George Herman, CIO of Citadel, noted that the US equity markets have rallied on the back of the AI theme and caused an upward rerating towards historically high levels. "US Treasury yields have also rallied as inflation came under control and [further] Fed rate cuts loom on the horizon. Meanwhile Europe and China are still battling to find a catalyst to economic growth.

"The slowing Chinese growth has pressured commodities," Herman added. "With still-elevated geopolitical risks around, we'd argue for a very cautious and well-diversified asset allocation setting with below neutral risk."

Claire Rentzke, CIO of Sukha & Associates, believes the world has reached the turning point in the interest-rate cycle since the US Fed cut rates for the first time in four years. "The pace and size of future cuts is still an unknown, which will be determined by the ongoing path of inflation and the labour market. Whether the US can navigate through a soft landing and avoid a recession still remains to be seen," she said.

"A US recession will impact global markets and economic growth," Rentzke

argued. “The outcome of the US election could also be a key factor for the path that the US follows.”

“Geopolitical tensions are heightened and the US election... could affect international relations as well. Investors still remain wary of emerging markets but these offer good relative value. China has struggled to kickstart its lagging market and high amounts of debt are a concern in China and other key markets too.”

Turning to the implications for the domestic outlook, Rentzke continued: “Locally, the SA equity and bond markets are both looking favourable. The new government and the improved outlook have lifted a lot of the negativity that shrouded local companies and the local bond market. There are still risks which abound as the new government will need to deliver and the level of debt will need to be controlled. Economic growth will need to be kick-started or companies will struggle to sustain improved earnings. It does however feel as though the worst is behind us and the outlook is much more positive.”

Kagiso Mathole, portfolio manager at Momentum Investments, also took a nuanced view of the global outlook and its potential repercussions for the local market in SA: “The current environment of lower inflation and lower interest rates could see support for local equities and for emerging markets,” he argued.

The recent stimulus announced by China took market participants by surprise, Mathole added, with stimulus measures including interest-rate cuts, a reduced reserve requirement ratio and a further relaxation in mortgage rules: “Despite these additional measures surpassing the market’s expectations, more needs to be done to sustain growth and align it with the more favourable shift in market sentiment.”

Meanwhile, a lot would also depend on the US Federal Open Market Committee (FOMC), which had launched its long-awaited interest rate-cutting cycle in September with a 50-basis point cut and had indicated two further rate reductions before the end of the year, Mathole continued: “Projections now show the median FOMC member expecting to cut rates by an additional 100 basis points in 2025... [but] confidence in easing inflation could shift the Federal Reserve’s focus from price pressures to concerns over softening employment and weaker growth. Although economic activity remains solid for now, growth is projected to slow.”

Locally, the formation of a Government of National Unity has sparked hopes of accelerating growth in the years ahead, Mathole agreed, adding:



George Herman

“Structural reforms aimed at improving industrial competitiveness and boosting productive capacity are expected to bear fruit in the medium term, while increased investment in renewable energy and higher consumption should lift growth in 2025.”

Jacques de Kock, analyst and portfolio manager at MitonOptimal, offered a similar view: “We are overweight South African risk assets in our local multi-asset portfolios. Globally we are slightly underweight risk assets, but neutral on developed-market equities versus emerging-market equities. We are allocated mostly to the lower side of the yield curve when it comes to both local and global bonds with minimal exposure to credit.”

Equity and fixed income markets have been complex this year, with geopolitical pressures, elections in SA and the US, and anticipated interest-rate moves from central banks. What are the downside risks for investors?

Investors cited a range of risks, both globally and locally.

As Anthony Hall, investment manager at Corion Capital, put it: “The downside risks in the fixed income market remain those of inflation and rate cut expectations. The market is pricing in quite aggressive rate cuts and if these don’t materialise and inflation starts to tick up again due to geopolitical events, we could reverse recent gains we have seen in the fixed income space.”

“In the equity markets, the risk is always there of a recession due to a slowdown in global growth,” Hall added. “Once again, geopolitical pressures are a concern, though it is also important to remember that there is very seldom a time when this isn’t the case.”

Some respondents cited specific risks,

such as François Cilliers of 2IP, who said: “The downside risks are almost certainly in US tech company valuations (which have provided solid earnings visibility in the main) becoming overstretched, as well as potential over-optimism in the bond market regarding forthcoming rate cuts.”

George Herman of Citadel cited some other potential worries: “Services inflation is very sticky and could prevent yields from declining as fast as is currently priced into the markets,” he said. “An increase in job losses in the US, causing unemployment to rise rapidly, could also dump the US rapidly into recession.”

Geopolitics could always cause surprises, Herman added, as well as a further cooling in China – without further stimulus forthcoming – which he argued could pressure risk assets dramatically. Plus a further unwind of the Japanese carry trade would stoke latent volatility.

“The risk looming largest is the potential for a US recession,” argued Claire Rentzke of Sukha & Associates. “US rates have started to decline but there are areas of weakness that could lead the US into potential recession.”

“The run-up in tech stocks has opened a valuation distortion between sectors in the US and the US equity market relative to other markets,” she also argued. “At stretched valuations, there is always downside risk but with new technology and unrelenting demand there is always the possibility of more upside.”

“Global bonds have become much more attractive but if rates don’t fall as fast or as much as expected these could still be volatile,” Rentzke also warned. “Uncertainty brings volatility and there are a number of continuing areas – such as with inflation, interest rates, geopolitics and growth – where the outlook is not clear and these will be tricky to navigate.”

For South Africa in particular, Kagiso Mathole of Momentum said: “The biggest risk would be if the GNU were to be rendered unstable. While the political parties in the unit will differ from time to time on certain policies and execution of tasks, the opposing parties outside the GNU may [also] add pressure to the unity. The US election outcome may also lead to the next round of a US/China trade war, which has proven bad for our equity and fixed income markets.”

Given Phaladi of Regive also offered some comments on SA and the market rally following the announcement of the GNU: “We are going to see the GNU being tested as the ANC continues to introduce some policies not favourable to other members of the GNU – and as all political parties gear for local election campaigns.”

“Interest-rate movements will be overshadowed by the US elections, with a possibility of them remaining high for longer than expected,” Phaladi added: “Donald Trump may be problematic for US citizens, but he has been very good for the hedge fund market due to the influence of his policies in the global market.”

One of three respondents who chose to remain anonymous also highlighted potential worries for SA: “A breakup in the GNU coalition would potentially result in permanent capital loss and represents the single greatest risk to SA investors,” this investor said. “A deeper recession and increased global conflict could also have a negative impact on returns.”

Elmien Wagenaar of THINK.CAPITAL highlighted a more generic source of risk: “The downside risk to investors is that they take too little or too much risk and, through that, capture returns that are too low.

“Over the past decade, relatively high returns were captured through low-volatility instruments due first to falling and then to consistently low interest rates,” Wagenaar went on. “This we believe is now behind us, so the one downside risk [going forward] may be lower-than-expected growth from low-risk assets.

“A second downside risk is unproductive volatility – high volatility generating mediocre returns, while more moderate and targeted risk-taking may capture more upside.”

Which asset classes offer upside for investors in the current climate? Should hedge funds be part of the mix?

There was plenty of enthusiasm for hedge funds in general – and for those focused on equities in particular among the respondents, with various investors citing the fact that local long/short managers have a long track record of outperforming.

But respondents did also cite some other asset classes as of interest too, with George Herman of Citadel, for instance, highlighting commodities.

“We feel that SA equity and SA property offer the best upside potential at these valuations,” added Jacques de Kock of MitonOptimal. “And we feel hedge funds have a big role to play within our client portfolios as diversifiers to our current long-only exposure.”

“SA equity remains cheap relative to its history,” argued Claire Rentzke of Sukha & Associates. “There are currently some very attractive opportunities for generating returns especially as the outlook locally starts to improve post elections and



Given Phaladi

post load shedding.”

However, Rentzke also noted that there are still risks as the consumer remains under pressure from the escalating cost of living and reduced purchasing power. “Foreigners have not yet returned to the local market and if there are issues in the US economy they may well not return for some while,” she added. “Local bonds have done incredibly well but still offer attractive yields, meaning there is little compensation for investors to take on additional risk through allocating to equity – with bonds providing compelling inflation-beating returns.”

“Globally, equities have been very strong over the last decade and have continued to run but with more volatility of late,” Rentzke continued. “Performance has been concentrated and there are still sectors and regions that offer upside because they have remained cheap. Emerging markets also offer upside but investors need to be selective as there are risks with increased geopolitical tensions.”

François Cilliers of ZIP took up a similar theme: “Investors will either have to be a little more judicial in picking their asset class and geographic exposure going into the tail-end of the year,” he said, “or they will need to utilise strategies that are more ideally suited to take advantage of more increases in market volatility, such as hedge.”

“Hedge funds should always be part of the mix due simply to the added tools at their disposal that traditional long-only managers aren’t allowed to access due to regulations,” agreed Anthony Hall of Corion. “These additional tools such as shorting and utilising leverage mean that hedge funds have the opportunity to do well in all market conditions.”

“Hedge funds should form a huge building block in asset allocation due to their ability to absorb the overall volatility of the portfolio while enhancing re-

turns in the process,” concurred Given Phaladi of Regive. “With the introduction of the two-pot system [which allows a portion of early withdrawals for retirement investors], we believe that the liquid part will attract hedge fund investment relative to other alternative investments such as private equity.”

Elmien Wagenaar of THINK.CAPITAL argued that acceptance of hedge funds as part of the investor toolkit had taken a significant step forward in recent years. “I find that I do not have to argue for hedge funds as a viable contribution to client portfolios anymore,” she said. “The resistance is not on the level of ‘should hedge funds be part of the mix’ anymore. But the resistance is not gone. It has shifted to the question of ‘which hedge funds should be part of the mix?’.

“Twenty-two years of allocating to hedge funds through various cycles has taught me that this is an equally important question that should not be separated from the first,” Wagenaar added. “The mix matters.”

“Hedge funds should definitely form part of the mix,” agreed Kagiso Mathole of Momentum, “especially when equities and bonds are expected to offer upside potential. The volatility in those asset classes should be brought down by allocation to hedge funds.”

“Hedge funds always offer the ability to apply beta risk budget elsewhere,” added George Herman of Citadel.

Hedge fund returns are positive this year, with the HedgeNews Africa South African Single-Manager Composite adding a median 13.5% this year to the end of September while global markets have climbed amid significant volatility. Are you satisfied with the way hedge fund managers are performing?

Investors were generally very satisfied with hedge fund performance from the local industry – at least for the first nine months of 2024. As one anonymous respondent put it: “Most managers have produced attractive returns without taking undue risk.”

Elmien Wagenaar of THINK.CAPITAL explained her view as follows: “Hedge fund strategies globally are diverse. And South African strategies are no different.” The volatility of the funds in question ranged from 0.93% and 32.81% over the period, she pointed out, and the returns between -5.98% and 22.1%.

“This gives ample opportunity for one investor, with a specific selection, to be completely satisfied – while another with

Investor survey 2024 data

2023, 2022 and 2021 survey results are in light blue

1 Do you expect the industry to grow in the next 12 months?



2 If so, where do you expect investor inflows to come from in the next 12 months?



3 Where do you think the growth will be directed?



4 How will the industry grow in the next 12 months?



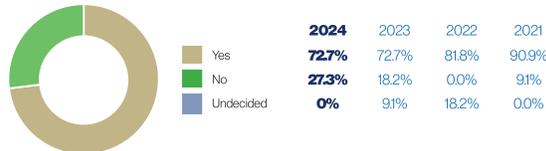
5 What kinds of strategies do you think will come to market in the next 12 months?



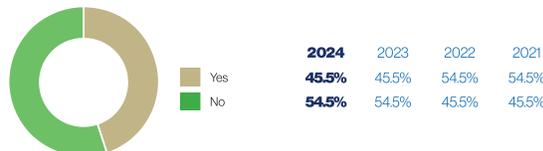
6 Are higher barriers to entry restricting growth in the hedge fund industry?



7 Does the South African industry have sufficient capacity to double in size (from current AUM levels of around R83 billion in single-manager assets)?



8 Are you allocating to early-stage managers?



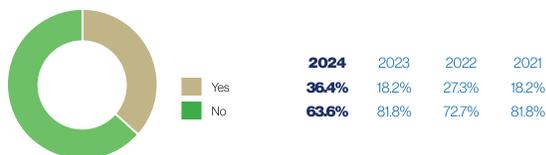
9 Are fee levels in the South African hedge fund industry:



10 In your opinion, are manager and investor interests aligned?



11 Are you seeing sufficient new talent coming to market?



12 Do you expect current and prospective investors to:



13 Have you exited hedge fund investments this year based on return?



14 Are you confident that hedge funds can meet their stated objectives in the next 12 months?



*HedgeNews Africa received responses from 11 fund of funds, advisers and consultants to this year's investor survey, which was undertaken in September/October 2024. We thank them for taking the time to participate in this important research.

a different selection to be utterly disappointed,” said Wagenaar. “The job of an allocator is to navigate this reality, not only over one year or two, but over all investment periods to the satisfaction of their clients.”

“Hedge funds are performing very well amidst a concentrated opportunity set,” argued George Herman of Citadel. “A small number of stocks are dragging equities higher and bonds are also running, with spreads at historic narrows.”

“Our own hedge fund portfolios have done exceptionally well versus their benchmark and return objectives, so we are very pleased,” concurred Jacques de Kock of MitonOptimal.

“It is easy to be greedy in our industry,” argued Anthony Hall of Corion. “However, in general, the recent performance of the hedge fund industry in South Africa has been exceptionally pleasing. There will always be funds that struggle, but on the whole most hedge funds have had a good 2024 to date. The industry has become very competitive, but as we have seen with the Springboks, competition for places makes for a better team.”

“One always hopes for outsized returns from more specialised or concentrated strategies such as hedge, but given the lack of market volatility for most of the year, hedge funds have availed themselves quite well in the main,” said François Cilliers of 2IP. “Again there have been strategies that have done particularly well, as well as funds that have materially underperformed the median.”

“There is a large dispersion between the returns of various managers,” agreed Claire Rentzke of Sukha & Associates. “Overall, managers have performed well and we are satisfied with what our managers have done from a performance perspective. The other benefit that we have seen from our hedge fund exposure has been the uncorrelated nature of the returns delivered.”

Which hedge fund strategies offer the most potential in current market conditions, and why?

There was, as in previous surveys, plenty of enthusiasm for equity long/short strategies, and also for multi-strategy approaches for the years ahead – though a little less this time for fixed income or market-neutral strategies.

Kagiso Mathole of Momentum was one who highlighted traditionally dominant areas such as equity long/short and fixed income arbitrage as continuing to be the areas of most promise.

Elmien Wagenaar of THINK.CAPITAL, on the other hand, highlighted “a



François Cilliers

multi-asset, multi-strategy approach”.

Anthony Hall of Corion Capital explained his view as follows: “Multi-strategy hedge funds that can be agile in these volatile times should offer the most potential. The markets are generally very dislocated at present, and opportunities abound for managers that can quickly allocate risk budget as macro events unfold.”

And George Herman of Citadel said: “Multi-strategy has the ability to switch towards performing strategies quickly.”

Jacques de Kock of MitonOptimal added: “I think long/short (long-biased) hedge funds and multi-strategies focused on arbitrage opportunities should benefit most from a volatile market. We do feel that there is lots more upside in certain geographic areas (in SA and emerging markets, for instance) and long-biased managers should also be able to benefit from this.”

Given Phaladi of Regive Capital had a slightly different view: “Arguably, market-neutral strategies should triumph in these market conditions. However, the shrinking JSE has limited the available opportunity set. We see multi-strategy



Claire Rentzke

and less directional strategies being the best contenders going forward.”

François Cilliers of 2IP said: “Pretty much the entire ambit of hedge fund strategies available to SA investors offer potential for upside returns, from long/short and fixed income hedge to market neutral – where the latter typically offers lower market exposure and benefits from increased volatility and trading opportunities.”

There was arguably a little less enthusiasm for fixed income approaches than in previous years. As one anonymous respondent put it: “Fixed income has already priced in a lot of interest-rate cuts – so could be more difficult going forward.”

One exception was Claire Rentzke of Sukha & Associates, who said: “With the dispersion in valuations and an uncertain interest-rate and economic growth outlook, both fixed income and equity long/short strategies could benefit.

“Those managers who use the full array of strategies available to them have the highest chance of being able to make returns in all markets. Dispersion of views and dispersion of valuations will create opportunities.”

What do you look for when allocating to a hedge fund manager, and what will cause you to redeem from a manager?

Investors cited a range of factors they take into account when deciding whether to allocate to a manager and when to redeem – including, of course, the ability to generate absolute returns on an ongoing basis, as well as qualitative factors like experience in the team and flexibility of approach.

“We typically look for hedge funds that offer a risk-and-return profile different to what is available on the long-only side or through a passive strategy,” said Claire Rentzke of Sukha & Associates. “The hedge fund manager must have an investment process that differentiates them, is well thought out, understands the varying nature of risk and can be well articulated. They need to be able to convince clients of their value-add.

“We look for hedge funds that have a demonstrable track record of adding value through time and have experienced, stable teams,” Rentzke added. “The fund must complement the existing strategies that are in place, whether that is through return enhancement or risk mitigation.

“We would redeem from a manager who failed in managing their risk, who continued to deliver sub-par returns over multiple periods and where a key

person left without properly managing succession risk.”

Jacques de Kock of MitonOptimal said: “We feel that sticking to a strategy is very important. A well-developed strategy with clear parameters and an investment team that are experienced in their field are the most important factors.

“Secondly is stability and predictability within the outcomes of the strategy – and not taking undue risks for the sake of it,” de Kock added. “Performance comes and goes, but the one factor that would make us sell out of a specific fund or manager would be when they change strategy or philosophy because of bad performance.”

“A number of factors are considered when allocating to hedge fund managers,” said Kagiso Mathole of Momentum. These include but are not limited to: consistent philosophy and process; a team with relevant experience (especially of key staff); idea generation; conviction and implementation or execution of ideas; use of hedge fund tools for both hedging and performance enhancement; transparency; and reasonable fees.

“Things such as persistent underperformance (not meeting funds’ objectives), inconsistent philosophy and process and loss of key staff are likely to lead to redemption from a manager,” Mathole added.

“We look for an ability to deliver the return signature that could be expected from the strategy employed,” said George Herman of Citadel. “Nothing drives redemptions faster than style-drift and poor risk management.”

“Consistency in how the espoused strategy is executed, along with a track record that evidences the latter are key elements,” concurred François Cilliers of ZIP. “Very material changes in the team (or an inability to attract and retain suitable talent), deviations from style or increases in business risk (operationally or in terms of material declines in AUM) are all valid reasons for revisiting and potentially revising an investment decision.”

“For us, when allocating to a manager, we assess and rate numerous factors,” said Anthony Hall of Corion Capital. “One: the portfolio manager – how experienced, passionate, focused, invested, and motivated are they? Two: track record – has the manager performed as expected? Three: strategy – is the strategy clearly defined and articulated and does it offer something different? And four: alignment – are the interests of the manager aligned with those of the investors?”

“We will redeem if any of the above factors are compromised,” Hall added.

“For us, managers come as final im-



Kagiso Mathole

plementers of strategies and we take time to evaluate them, thus running a very concentrated portfolio,” explained Given Phaladi of Regive. “We do not like unexplained and consistent underperformance, and any disparity of information may result in redemption. We also track transformation and job statistics across the managers we have invested in – to have meaningful conversation around such matters.”

Elmien Wagenaar of THINK.CAPITAL said that currently she was seeing quite a few hedge fund model portfolios being constructed mostly using quantitative methods. “The back-tested returns of these newly constructed combinations are significantly higher than the actual returns of any of the hedge fund of funds in existence over the past 10 years and longer,” she noted.

“On the most basic level, the return differences should cast doubt on one of the two outcomes. Have hedge fund of fund managers, like me, offered poor hedge fund solutions to trusting investors for over a decade? Or does the return of the back-tested solutions include a knowledge premium due to having full hindsight, which then disappears very quickly when managing an actual portfolio in real time with no foresight?”

“Our portfolio construction is highly qualitative,” Wagenaar added. “We ask, for instance: which factors are driving fixed income hedge funds as a grouping? Which factors are driving individual funds? Are there fundamental reasons for the returns to be repeated? The same questions are constantly asked for equity hedge funds too.”

“The main question that should be asked now, in my mind, is what the fixed income versus equity split in the portfolio should be. And which funds should represent these overarching groupings. This will dictate which funds are bought and sold.”

What types of hedge fund strategies would you like to see come to market in South Africa?

Respondents offered a very diverse wish-list of strategies they would like to see coming to market in SA.

Given Phaladi of Regive, for instance, said he would like to see more market-neutral funds including those that can offer a pair trading approach.

Kagiso Mathole of Momentum called for more systematic, AI-driven hedge funds.

George Herman of Citadel said he would like to see the emergence of more large multi-strategy platforms.

And one anonymous respondent called for more commodity-focused funds.

Anthony Hall of Corion called for more strategies with a global focus: “The managers in South Africa generally know the local landscape exceptionally well, but it’s time to think beyond our borders,” he said.

“There is already a good availability of hedge fund strategies in the South African market,” argued Claire Rentzke of Sukha & Associates. “More fixed income strategies and more true multi-strategy funds could contribute to the current mix of funds.”

Others answered the question in a more generic way, including Elmien Wagenaar of THINK.CAPITAL, who said: “It is more important to me that we find managers following strategies they have a specific skill in. Such a strategy will be diversified from the next, even if it uses the same assets to implement.”

And François Cilliers of ZIP replied as follows: “Strategy availability should reflect existing skill and talent, which SA has in relative abundance. There is no need for the tail to wag the dog by trying to cater for strategies where they do not make structural sense in SA, or where opportunities are more scarce.”

Is the South African industry making progress on ESG (environmental, social and governance) factors?

As in previous surveys, there were some very mixed views on ESG in South Africa – ranging from those who felt there had been little or no progress to those who felt there had been quite a lot of progress, but with many saying a lot more needs to be done.

George Herman of Citadel was among those taking a more sceptical view. There had been no progress he said, adding simply: “Investors are not endorsing it.”

François Cilliers of ZIP was another with a slightly sceptical if more nuanced

view: “ESG factors, as far as they are relevant to the long-term sustainable and good governance of business, have long been incorporated within many managers’ selection criteria,” he said. But he added: “Green-washing for the sake of marketing, or to the extent that it does not benefit end investors, one could argue is a potential dereliction of fiduciary responsibility and managers need to be very wary of doing so.”

“There is a limit [on what] hedge fund managers can do on ESG factors,” agreed Given Phaladi of Regive. “But there has to be a concerted effort in bringing new entrants into the space, particularly women and black candidates. The same should apply at board level by driving transformation there. The other factors such as environmental and governance are already being integrated in the investment process.

“There should be an emphasis also on building an investment team at the fund manager level and avoiding key-man risk,” Phaladi added. “And [the] corporate governance structure is key in achieving such.”

“The industry has mainly made progress on the governance factors,” argued Anthony Hall of Corion. “However, we feel there is still much more that can be done on the social factors, especially considering all the issues we constantly grapple with in South Africa due to our disturbing Gini coefficient [which measures global inequality].”

“We believe significantly more can be done,” agreed Elmien Wagenaar of THINK.CAPITAL. “We all think we know what these terms mean and think our businesses are adding value.” But that may not be the case in reality, she argued.

“In my experience, there are four stages of impact. It starts with disaster management. This is typically the actions a business is forced to take as a result of regulation or large investor activism. Then comes compliance when the required goals are met.

“A sign of progress is when integration occurs – and ESG goals become part of all decisions and incentives,” Wagenaar went on. “The final stage is when impact becomes the purpose – using the activities of the business for impact.

“As an allocator of capital within the South African context, we are working on ways to measure especially social impact and to effect change through these measurements. In the meantime, I challenge all readers to consider at what stage of impact their businesses find themselves.”

“ESG is multi-faceted and complex and the outcomes can be very hard to measure in a standardised way,” argued Claire Rentzke of Sukha & Associates.



Jacques de Kock

“Ultimately it comes down to the sustainability of the businesses in which you invest but it requires a long-term horizon. There has been a lot of work done but there is also a lot more to still be done and industry collaboration would be beneficial in this area too.”

Is the South African hedge fund industry making progress on transformation?

South African hedge funds also got a mixed report card from investors on the complex issue of transformation.

There had “absolutely” been some progress, argued many, including George Herman of Citadel.

Anthony Hall of Corion agreed, but also felt it had been far too slow: “I don’t believe the problem lies squarely at the doors of the managers, but has more to do with the barriers to enter in terms of the cost of managing a hedge fund and the lack of flows over the last while,” he argued.

“The fact that the industry has not really grown in recent years, has definitely had an impact on transformation efforts,” agreed Kagiso Mathole of Momentum. “That being said, there are some success stories in the industry.”

As with the ESG issue, Given Phaladi of Regive also felt that the progress had been very slow: “The biggest hurdle is around the ‘how’ part, particularly with boutique managers where owners are still involved on a daily basis. We always think a peer-to-peer conversation can yield results, and it always starts with a willing party and intention to transform.”

“There is slow progress,” agreed Claire Rentzke of Sukha & Associates. “There are a few managers doing really great work in this space and actually working at developing young talent and ensuring that those people rise through the ranks. There are also those manag-

ers doing very little in this space.”

“Good BEE (black economic empowerment) talent is in very high demand,” argued François Cilliers of 2IP. “However, firms need to be wary of tokenism or transformation for transformation’s sake, for the reasons mentioned. Not only is the latter disingenuous, but managers need to focus on their mandate. Most larger hedge funds also have mentor or intern programmes which try to foster and grow budding BEE talent, which is always a good thing.”

Do you invest in private debt/credit and what is the opportunity set?

Just over half of the respondents to this year’s survey said their firms did invest in private debt or credit strategies as well as hedge funds.

Those who do included Anthony Hall of Corion, who said: “It’s a massive opportunity but with many hidden risks. As the saying goes, it’s all great until it isn’t.”

Given Phaladi of Regive said: “Yes, we’ve used private debt in our PE funds in order to limit a deep J-curve.”

“Momentum does have a private credit fund,” confirmed Kagiso Mathole. “The opportunity set remains favourable for the strategy as there are pockets of the market under-served by banks for regulatory reasons.

“This is most often in the SME sector which is very important for job creation and economic growth in the country,” Mathole added. “The team continues to see interesting opportunities in this space.”

“There are a lot of varied opportunities here,” agreed Claire Rentzke of Sukha & Associates. “Our banking sector excludes a large number of individuals and businesses and the growth of the real economy can be hindered through this lack of access to finance and capital.

“Private debt can allow investors to access various under-represented sectors of the economy, businesses at varying stages of development and along varying parts of the capital structure,” Rentzke continued. “While it is not risk-free, the earlier-stage cash flows can reduce liquidity implications for investors and ensure returns come through earlier in the life of the investment.”

George Herman confirmed that Citadel is also among those active in the space, while several others do not invest there.

“Unfortunately, our client base and product offering does not allow us to invest into private debt/credit structures,” explained Jacques de Kock of MitonOptimal.

François Cilliers said 2IP also avoided

the space, explaining the rationale as follows: “One has to be very careful with certain investment types, even corporate credit, as recent history clearly illustrated,” he said. “A lack of liquidity should very clearly reflect in the liquidity premium embedded or alternatively, be approached with disproportionate skill and care.”

Do you invest in private equity and other alternatives? What do these asset types have to offer within a broader alternative asset allocation?

A slightly smaller proportion of respondents said their firms also invest in private equity, which is, by definition, a longer-term investment strategy area and, therefore, more illiquid than private credit – which can offer a broader spectrum of liquidity.

Those who don’t included Citadel, MitonOptimal and THINK.CAPITAL.

“We don’t currently invest in private equity but do acknowledge that there are many benefits of such [funds],” explained Anthony Hall of Corion, who cited the liquidity constraints. “Corion only manages retail hedge funds and, therefore, we have to be very aware of the liquidity of the underlying assets.”

François Cilliers cited the different skillsets required in the PE space: “An enormous amount of skill, knowledge, legal understanding and patience are required in order to invest in less homogeneous, less liquid, often more opaque, investments,” he argued.

“Whereas overseas markets have much greater standardisation and market breadth in this regard, SA investors – even pension investors – should be wary of chasing opportunities where price discovery and transparency are not readily available,” Cilliers added.

Among those who do invest in private equity alongside hedge funds and other alternatives is Momentum, with Kagiso Mathole explaining the overall approach as follows: “Momentum does have a private equity, private credit and hedge fund offering as part of the alternatives programme spanning fund of fund, hybrid and direct investment strategies,” he said.

“Alternative investments offer clients access to other sources of risk premia like illiquidity and complexity premia,” Mathole continued. “They further offer investors access to investment opportunities across the capital structure, which leads to diversified returns able to enhance investment portfolios.”

Claire Rentzke confirmed that Sukha & Associates is also active in private eq-

uity as well as private credit alongside hedge funds, explaining the overall approach as follows: “There is quite a large and diverse range of investment opportunities in private equity,” she said. “There are large, well-established companies that chose not to be listed and may be in sectors where there are limited opportunities for exposure in the listed market. Then there are small start-up businesses trying to get established, and a range in between.”

“You get the ability to access high-growth companies, new technologies and different sectors of the economy which may not have listed counters – but which can enhance diversification and also provide significant upside,” Rentzke added. “Additionally, often job creation in these high-growth sectors is much more significant than in the more established listed market companies.”

Another who allocates to PE is Given Phaladi of Regive, citing some similar reasons: “Transformation, job creation and other impact factors can be achieved through private equity investments,” he argued.

“There is a limitation [to stay] in listed markets with hedge funds – thus a need for more robust engagement in the unlisted space with other alternatives,” Phaladi added. “We also include structuring around a listed market, such as customised market-linked notes with customised payment profiles – to manage risk associated with market beta.”

In your view what is the optimal blend of alternatives – including hedge funds, private equity, private debt etc – in a broader investment portfolio?

Respondents struggled to cite a single formula for the most optimal blend of alternatives in a portfolio.

As Given Phaladi of Regive put it: “There is no one-size-fits-all in the optimal allocation – as there are other factors investors need to consider, such as: success of traditional managers; a need for alpha versus beta; returns above cost; and a need for impact investing.”

“I do not think that exists,” agreed Jacques de Kock of MitonOptimal. “It’s a function of risk appetite and return objective requirements. The desired exposure will depend on the type of client, the type of product and the intention of the investment – for example, you can’t compare an investment into an RA (retirement annuity) with an investment into a living annuity.”

“It is extremely important to us that asset allocators, financial advisors and clients alike understand that [when

talking about client portfolios] it’s not a ‘one-size-fits-all’ type of investment strategy and that your percentage allocation will depend on a wide range of factors,” de Kock added.

“The answer is very dependent on the risk profile of the portfolio,” concurred Anthony Hall of Corion. “However, we feel that it should be a meaningful exposure.”

“Alternatives are generally more expensive than traditional asset classes,” Hall continued. “So this also has to be factored into the equation in terms of how fee sensitive the investor is. Often it feels as if the savings industry is solely focused on fees and ignores discussions on the net return – after fees.”

Elmien Wagenaar of THINK.CAPITAL was one who did venture to put a number on it: “The investment product will dictate the answer,” she said. “Private equity and private debt carry illiquidity and concentration premiums (and risk), while the typical hedge funds don’t.

“The right combination of hedge funds can serve as an optimal blend to complement traditional assets, without needing diversification from other alternative assets,” Wagenaar continued. “A 20% allocation to a diversified selection of hedge funds will definitely make a difference.”

“An optimal allocation depends both on the mandate, investor risk appetite and market environment,” said François Cilliers of ZIP. “Generically one could make a strong argument for a 10%-20% allocation to hedge, depending on regulatory constraints.”

“We like hedge funds in all multi-asset solutions as it lowers drawdown and correlation to traditional markets,” added George Herman of Citadel.

“The optimal allocation may well change through time especially if we see higher levels of preservation in the retirement savings industry into the future,” said Claire Rentzke of Sukha & Associates. “Alternative strategies can be quite different and so the risk and return profiles of the various investment opportunities need to be understood, as well as the correlations to other asset classes.

“They all come with unique nuances and taking the time to understand these is important in creating robust portfolios and delivering good outcomes and experiences,” Rentzke added. “Private debt offers the feature of early cash flows and of being self-liquidating. Private equity takes a longer-term view and returns typically come through much later in the life of the fund. The blend of closed-ended partnership structures

and open-ended funds needs to be looked at, as well as the vintage years of the strategies – which can impact returns.”

All of the alternatives are necessary in an optimal portfolio, argued Kagiso Mathole of Momentum: “As long as they are blended and sized in such a way that caters for liquidity to meet the clients’ needs,” he stressed. “Due to higher liquidity in hedge funds as compared to other alternatives, it would make sense to max the exposure in the asset class, if Regulation 28 [of the Pension Funds Act] is considered.”

Do you invest in both global hedge funds and domestic hedge funds? If so, does your approach differ?

A majority of the investors surveyed said they invest only in local managers, including Momentum, Corion and THINK.CAPITAL – though some pointed out these managers may also offer exposure to global assets in their portfolios. And there were also some exceptions.

“We invest in both global and local hedge funds,” said George Herman of Citadel, for instance. “Our process doesn’t differ, but the opportunity set and style expression in global is much larger. Diversification is easier in global, but the overall cost is also higher.”

“Both have their role to play,” said Jacques de Kock of MitonOptimal. “But in our products we have mostly South African clients with ZAR liabilities, so any global exposure that is not ZAR based is seen as a diversifier. For now, we feel that our local managers have enough opportunities within their chosen markets to be able to fulfil their required objectives.”

François Cilliers said 2IP invested predominantly in local managers and preferably utilising a party which specialises in hedge, although had also invested in global hedge funds in the past.

“We have invested with local managers only,” said Claire Rentzke of Sukha. “However, some of the strategies do include allocations to global assets. Locally the regulation is understood much better and the managers are all known. Whereas globally there is a much bigger universe and the regulations are not as structured around hedge funds and differ from region to region.

“While there is now much more scope for including hedge funds in the global allocation to provide a holistic offshore investment strategy, this does not necessarily mean that we would ship assets overseas and not support the



Anthony Hall

local industry and local job creation – where it makes sense to do so,” she said.

What is your outlook for the South African hedge fund industry in the next five years? In your view, what are the most pressing issues that need to be addressed?

Respondents offered some diverse views on the outlook for the industry in South Africa, although most were very positive and upbeat about the prospects ahead – despite issues that need to be addressed, which most saw as being on the regulatory side.

“The outlook for the SA hedge industry remains promising,” said François Cilliers of 2IP. “The most attractive vehicles in our view – absent to where an investor has access to a dedicated, experienced team which follows hedge funds almost exclusively – would be accessing or utilising some of the independent fund of hedge fund talent locally.

“There is a small handful of managers who focus solely on hedge and the investment and operational due diligence of the latter, with very long, consistent track records,” Cilliers added.

“Positive” was the first word on the outlook from Kagiso Mathole of Momentum. “The most pressing issue would be to finalise the amendment to Board Notice 90, allowing collective investment schemes (CIS) to invest in hedge funds.

“This amendment, together with continued education and information sharing among stakeholders and potential clients, will definitely lead to hedge funds being more popular and widely accepted as permanent features in investment portfolios,” Mathole added.

“We are exceptionally positive on the outlook for the SA hedge fund indus-

try,” agreed Anthony Hall of Corion. “The most pressing issue at the moment is mainly to do with regulations and, in particular, allowing traditional CIS funds to invest in hedge funds. Individuals are allowed to invest in hedge funds, so it makes no sense that traditional CIS funds are restricted from doing so.”

Regulation that allows CIS vehicles to invest in hedge fund CIS vehicles was also the top issue to be resolved for George Herman of Citadel. “Simple!” he said.

“I think that the hedge fund industry will continue to grow as more investors are attracted by the better performance numbers that have been seen,” argued Claire Rentzke of Sukha. “Hedge funds will also be attractive if the long-only space in South Africa continues to struggle to deliver sustainable alpha and investors include more passive [allocations].

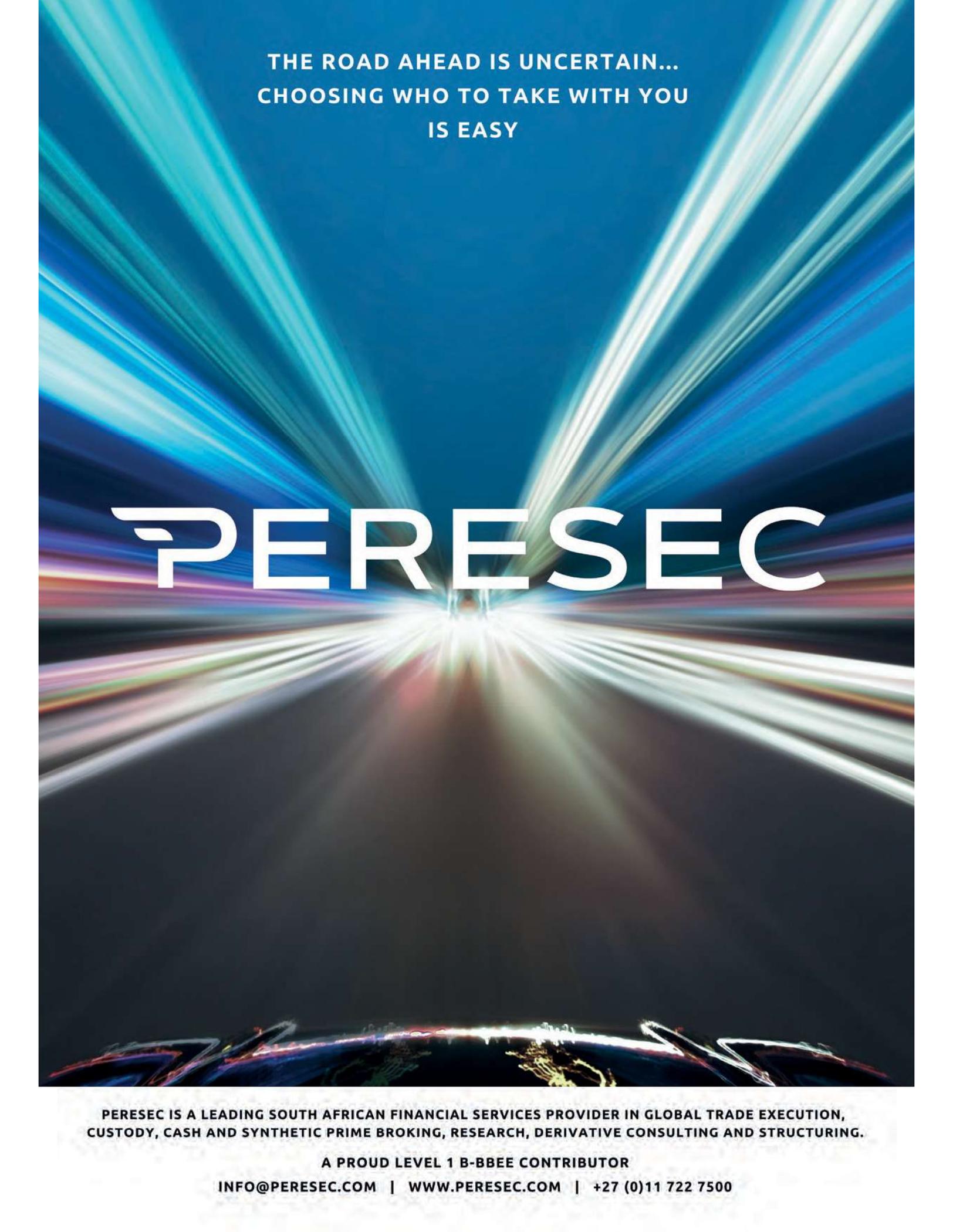
“Amendments in regulation could also lead to increases in allocations if BN90 is changed to allow hedge funds in multi-asset CIS portfolios,” Rentzke added. “Costs still need to be addressed though as the value chain continues to expand – and leak performance from the end investor. The broader costs involved in administration – manco fees, trustee fees, risk management fees – all increase the costs to investors and reduce returns. The value-add of many of these services needs to be assessed and questioned.”

“We should find a standardised way of measuring asset allocation risks,” said Jacques de Kock of MitonOptimal. “Just knowing long positions and short positions is not enough to evaluate risks within a portfolio. And that needs to align with the fees that the managers charge.”

Given Phaladi of Regive cited a number of issues going forward – including transformation (and how to address it); looking again at hurdle rates aligned to client interests; and conflict of interest issues with internal portfolios.

“In my mind, the most pressing issue at this juncture for the industry is that the new investors do not get disappointed or disillusioned,” argued Elmien Wagenaar of THINK.CAPITAL.

“Equally instrumental in this are the large funds that have also gained the most retail assets, and the new allocators who are building model portfolios,” she explained. “The large funds must continue to deliver superior returns and the model portfolio builders must navigate the realities of portfolio management in an asset class with much wider dispersion than long-only funds.”



THE ROAD AHEAD IS UNCERTAIN...
CHOOSING WHO TO TAKE WITH YOU
IS EASY

PERESEC

PERESEC IS A LEADING SOUTH AFRICAN FINANCIAL SERVICES PROVIDER IN GLOBAL TRADE EXECUTION, CUSTODY, CASH AND SYNTHETIC PRIME BROKING, RESEARCH, DERIVATIVE CONSULTING AND STRUCTURING.

A PROUD LEVEL 1 B-BBEE CONTRIBUTOR

INFO@PERESEC.COM | WWW.PERESEC.COM | +27 (0)11 722 7500