What is a hedge fund?

The term “hedge fund” is a misnomer.

Hedge funds invest in any number of strategies regardless of the common term that attempts to box them.

These strategies include investing in asset classes such as stocks, bonds, commodities or currencies.

Hedge funds are exposed to certain market risks, and hedged (see **What does it mean to hedge?)** against others.

One must ascertain on a case by case basis, therefore,

a) what a fund hedges,
b) how it hedges; and
c) how much it hedges.

The above is crucial to understanding a fund's performance.

What does it mean to hedge?

“Hedging" roughly means managing risk.

Typically, a money manager employs a particular hedging technique in order to mitigate a particular type of risk.

For instance, market risk - the risk of a decline in the overall market - can be hedged against by selling a broad collection of securities short in equal proportion to one's long exposure.

The same end could also be accomplished by buying put options on an index like the JSE.

Other types of risk often hedged against include interest rate, inflation, and large weightings in a sector, region, single company, or currency.

Are all hedge funds aggressive?

No. This is the greatest misconception regarding hedge funds.
Although some funds are aggressive, many other funds emphasise consistency of returns or protection of investors' capital.

Hedge funds cover a wide variety of investment strategies.

Who typically invests in hedge funds?

The largest investor in hedge funds in SA is pension funds.

However, over the recent years, investments by high-net worth individuals have markedly increased.

With hedge funds falling under the Collective Investment Schemes Act (which governs investments made by the wider public), hedge funds are now also available to individuals wanting to invest smaller amounts.

What is the difference between a qualified investor hedge fund ("QIHF") and retail investor hedge fund ("RIHF")?

In South Africa, two types of hedge funds exist; one for retail investors and the other for qualified investors.

The two types of hedge funds will be regulated differently, with the Retail Investor Hedge Funds (RIHF) regulated more strictly than the Qualified Investor Hedge Funds (QIHF), yet with both providing sufficient investor protection.

A QIHF may only receive investments from a "qualified investor".

This is any person, who invests a minimum investment amount of R1 million per hedge fund, and who-

a) has demonstrable knowledge and experience in financial and business matters which would enable the investor to assess the merits and risks of a hedge fund investment; or
b) has appointed a FSP who has demonstrable knowledge and experience to advise the investor regarding the merits and risks of a hedge fund investment.

A RIHF may receive investments from any investor and has no prescribed minimum investment.

What is the benefit of hedge funds in a total portfolio?

Different hedge funds can be used in different parts of a total portfolio.

Typically a combination of hedge fund is used in pension fund portfolios to reduce risk relative to equities in the same way that bonds are used in a traditional portfolio.

A good hedge fund portfolio can compete well with bonds on volatility measures, and outshine bonds on returns.

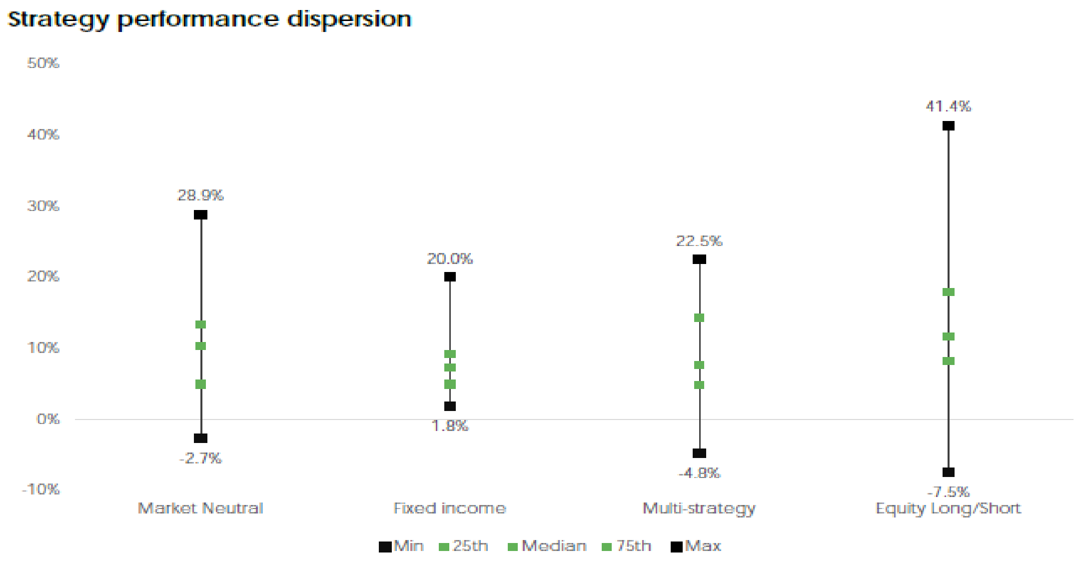
Some investors with a higher tolerance for risk are reluctant to invest in hedge funds as many of these funds lag equities in an up market - the reason for this lag is that upside is sacrificed in hedge funds in favour of consistent, positive returns.

Consequently, these investors then stay invested in equities rather than considering investing in a fund of hedge funds. However, this decision may be to their detriment as their investment portfolios cannot gain from any decline in the share prices of equities.

In contrast, if the portfolio included some investment in hedge funds that did not lag equities significantly, the portfolio could also have profited from falling share prices.

The RCIS THINK Growth QI Hedge Fund allows these investors to benefit from the wider set of investment opportunities relative to equities without forgoing longer term returns.

Why invest in a fund of hedge funds?



Source: 2015 Novare Hedge Fund Survey

The risk return characteristics of South African hedge funds are widely dispersed. Selection therefore matters. A fund of hedge funds focuses on the correct selection of underlying hedge funds to gain from the different return profiles of each of these funds to ultimately add value to an investor's total portfolio.

Please refer to the section below that details how the RCIS THINK Growth QI Hedge Fund's customised design can add value to its investors.

Why Invest in the RCIS THINK Growth QI Hedge Fund?

We believe that there are three reasons why an investor should consider investing in the Fund, namely:

a) the team's experience;
b) the Fund's innovative investment solutions; and
c) the Fund's performance to date.

<u>Experience</u>

The principal has 16 years of investment experience, including 14 years of hedge fund research and investment.

The THINK.CAPITAL team has significant experience in designing a Fund of Hedge funds, i.e. :

a) identifying and analysing and designing each underlying mandate to obtain a deep understanding of the risk exposure;
b) considering the relationship of exposures across these mandates,
c) selecting hedge fund managers with sufficiently diversified strategies for good risk management and to create different return profiles.

THINK.CAPITAL 's highly skilled and experienced team actively manages the portfolio. It performs ongoing reviews on the current mandates and continues to investigate potential new mandates to diversify the current portfolio.

Innovative solution

Unlike the typical fund of funds, the Fund's approach does not seek to generate absolute returns all of the time - rather, it allows for some contained downside some of the time to ultimately capture more upside.

However, a strong focus is still on delivering more positive months than negative months, and having the size of negative months smaller than the size of positive months. This results in effective compounding and superior longer term returns. Compounding occurs when gains are generated on the back of gains.

Effective gains are those that result in capital growth.

Ineffective gains are characteristic of the inescapable law of investment that for every loss incurred, a higher return is needed from an investment to recover to its initial capital value.

As losses increase, the gains needed for capital to recover increases exponentially.

The Fund view is that ultimately this strategy should result in an outperformance of equities.

Results

The Fund achieved very good results in 2015 - for every R100 invested, the Fund delivered R21.96 to investors, versus an investment in the South African equity market that delivered R5.12*.

*(*The Fund delivered 21.96%, and the FTSE/JSE All Share Index TR was up 5.12% for the year)*

The Fund was the winner of the HedgeNews Africa Fund of Hedge Funds (Multi Strategy) 2015 award.

How are hedge fund fees charged?

Management fee	0.75% (plus VAT) per annum payable monthly
Performance fee	15% (plus VAT) on the returns of the fund
Hurdle rate	Cash + 3%
A Life time high water mark applies.	

Explanatory notes

"Performance fee" means the % share of returns – thus the Fund may charge a 15% share of the returns, *but only* if:

a) a "hurdle" had been met;
b) the Fund is above its "high water mark"; and
c) the return after the fee is higher than the hurdle rate.

The hurdle rate is Cash+3%. Cash rates are currently circa 6% in SA, and therefore the hurdle rate is currently circa 9% (i.e. 6% + 3%). If cash rates increase or decrease, the hurdle rate will also increase or decrease.

"High water mark" means the highest fund value where a performance fee was previously charged. The Fund must be above its high water mark for a performance fee to be charged. In practice this means that the Fund can only charge once for a certain performance level. For example, where the Fund charged a performance fee and the Fund value subsequently decreases, it cannot charge another performance fee whilst recovering (i.e. reaching the same level as prior to the decrease in value).

Examples (note that the amounts are all excluding VAT)

We provide some examples of the fee calculation below for illustrative purposes.

a) If fund return = 10% (after management fee):

- The 10% is higher than 9% (the hurdle rate). Thus, a performance fee of 15% of the fund return (i.e. 10%) can be charged - resulting in a 1.5% performance fee.
- Note however that there is another provision that provides that the return to the client after fees may not be lower than the hurdle rate (i.e. 9% in this example). This means that the Fund's fee can actually only be 1%, otherwise the return to the client after fees would have been 8.5%, which is lower than the 9%.
- The total fee will therefore be 1.25% (i.e. the total of the 1% performance fee and the 0.25% management fee).

b) If fund return = 8% (after management fee):

- As the 8% return is lower than the 9% hurdle rate, the Fund may not charge a performance fee.
- The total fee will thus be 0.25%.

Other costs

The Fund will settle certain costs including:

a) fund administration costs,
b) fund audit fees, and
c) fund bank account costs .

Note that these costs will be deducted before the management and performance fees are calculated.

What is the cut-off date for investment in the RCIS THINK Growth QI Hedge Fund?

The payment will need to reflect before 14h00 on the 2nd last business day of the month prior to the investment month.

What is the redemption notice period?

One calendar month's notice.

When does the investor receive redemption proceeds?

The redemption proceeds will be paid out after the valuation is received from the administrator - this is typically approximately 15 days after the end of the redemption notice period.

When does the investor receive statements for his investment in the Fund?

Approximately 15 days after month end.

What are the tax implications?

In terms of the new regulations, hedge funds will be taxed on the conduit basis (i.e. the same as other collective investment schemes, e.g. unit trust funds). A tax certificate will be issued by the management company on an annual basis.

General

The RCIS Think Growth QI Hedge Fund is managed by THINK.CAPITAL Investment Management Proprietary Limited in terms of a discretionary mandate. THINK.CAPITAL is an authorised financial services provider (FSP 46714) in terms of the FAIS Act. This document has been compiled for information purposes only. It is provided in good faith and has been derived from sources believed to be reliable and accurate. No representation or warranty, express or implied, is made in relation to the accuracy or completeness of this information. It does not take into account the needs or circumstances of any person or constitute advice of any kind. It is not an offer to sell or an invitation to invest. Past investment performance is not a guarantee or indicative of future performance. Returns are subject to fluctuation and may be volatile. Returns are net of costs and for a particular fee class. An investor may not get back the full amount invested. No responsibility or liability is accepted by THINK.CAPITAL, its subsidiaries and its associated companies and/or the directors, employees or agents of THINK.CAPITAL for any loss arising from the use of this information. It is the investor's responsibility to inform him or herself of and comply with regulations and applicable laws in the relevant jurisdiction in which they operate. The RCIS THINK Growth QI Hedge Fund is a collective investment scheme regulated by the Financial Services Board.

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