

Hedge funds

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Hedge funds offer portfolio construction benefits, especially in an environment where investors – and particularly those drawing an income in retirement – are seeking more returns than traditional asset classes are delivering.

Hedging, with its origins in farming, is essentially a method to offset and spread risk. There's no standard definition for a hedge fund, but all hedge funds share similar characteristics, i.e. they are pooled investment vehicles, invest without constraint (they have a greater degree of freedom), and use derivatives and tools of modern finance which gives them the ability to produce positive returns regardless of the markets.

Global trends

Globally we're seeing an uptake in the use of hedge funds, particularly in pension and sovereign wealth funds, as well as in endowments, foundations and family offices – where preservation is key. In the US, some of the top endowment funds have a 25% allocation to absolute return hedge funds, and we see a 46% allocation to alternative investments in the average family office portfolio.

The evolution of hedge funds in South Africa

Hedge funds in SA are officially regulated and were declared a Collective Investment Scheme (CIS) in 2015. Subsequent to that, Regulation 28 of the Pension Funds Act now allows for a maximum allocation of 10% to hedge funds in a retirement portfolio. These funds offer transparency and high levels of governance, as well as access to diversified sources of returns in a weak economic environment. Increasing expertise, accessibility and pressure on fees work to fight any negative perception on the part of investors, from previous market failures.

Why do hedge funds fail?

The two main reasons hedge funds fail is due to operational risk (the biggest risk), or investment risk. The Glacier Invest team performs a full due diligence on both of these areas when

considering any particular fund for inclusion in a portfolio.

Benefits of hedge funds to portfolio construction

Including hedge funds in a portfolio opens up the efficient frontier and improves the Sharpe ratio (the performance of an investment compared to its risk). We see an upward shift of the efficient frontier, i.e. more return for living annuity investors, for every unit of risk.

In summary Hedge funds offer low correlation to other asset classes, portfolio construction benefits, and an attractive return profile for retirees.

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