

**Tilman Friedrich**

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**From:** Money Marketing [angelo@moneymarketing.co.za]  
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**To:** Tilman Friedrich  
**Subject:** MM : Evercrest hedge fund - due diligence wouldnt have helped

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**Evercrest - due diligence wouldn't have helped**

Hedge fund collapse has 'little' impact on fledgling local index, but institutional FoF investors take a R200m bath.

According to Clade Asset Managers Carl Liebenberg, managers of the index, they have finalized the data on the SA hedge Fund Index Fund performance for April 2007 - the month in which Evercrest lost 66%.

The index fund returned 2.05% for April in spite of the losses incurred by the Evercrest Hedge Fund. The South African Hedge Fund Index fund is a capital weighted index which aims to represent all open Hedge Funds in South Africa.

"When investing in the underlying managers Clade uses the current assets under management of each of the funds to determine their weightings in the index."

The implications of the positive returns of the index for April are as follows:

1. The Evercrest Fund was a small fund (less than 1% of the industry);
2. The impact of the losses of the fund were not material to the index fund or the SA Hedge Fund "asset class"

According to Lizelle Steyn, product manager at Nedgroup Investments, worldwide, the fund of funds (FoF) approach has proved to be the most popular and safest route for investing in hedge funds.

"I do think it is significantly riskier to invest directly in a single manager hedge fund, unless you have years of experience in researching and monitoring hedge funds. These products are truly for the more sophisticated investor," says Steyn.

" Some hedge fund managers choose an unregulated environment for a reason and tend to keep their mandate limits as unrestrictive as possible. If this was the case, the investor would have walked into the potential concentration and leverage risk of this fund with his/her eyes wide open.

"In terms of the Evercrest fund, one can only hope that they fully understood these risks before investing. If not, again, the fund of hedge funds manager would almost certainly have been fully cognisant of the risks and either refrained from investing, or allocated only a small portion of the fund of funds to Evercrest."

In terms of risk management, and a potential mandate breach, it is always advisable to have a prime broker or risk manager to report the breach to the investor.

**"Unfortunately not all hedge funds use one prime broker only and many do not appoint a risk manager."**

The tough questions that are asked should happen at the due diligence stage, and should be on the list of items that fund of funds managers check when performing such a due diligence.

Steyn says that one should bear in mind that hedge funds do not only utilise complicated investment strategies, but that the operational issues surrounding them are also more complex.

"Unlike the collective investment schemes environment, for example, there are not strict guidelines forcing a hedge fund manager to employ an independent custodian, report holdings to the FSB and, per definition, not go short or employ leverage," says Steyn.

And while the idea of employing an independent custodian is a sound one, it appears from other sources that in the Evercrest collapse the risk managers report is a monthly one, and by the time the FoFs got their report the fund was history. So the FoF institutional investors took a R200m bath.

"This is another reason why you might want the guidance of an experienced fund of funds manager who can explain the implications of investing in an unregulated environment," says Steyn.

On the other hand one industry source said that while the FoF generally undertake a due diligence, it doesn't stop the fund manager from making plain dumb or speculative trades in future.

**Editor's thoughts:**

\* The last comment is telling, and generally relates to all forms of investment.

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