

Follow the smart money to outperform markets

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Wild market swings often send investors rushing for the perceived safety of cash. But volatility and uncertainty often create opportunities for out-sized alpha generation. In a world where buy and hold 'beta-centric' strategies are unlikely to generate strong investment returns, hedge funds offer a compelling alternative for investors to consider.

The global hedge fund industry has attracted \$19bn worth of inflows in the first three months of 2022, the highest level of quarterly inflows since the second quarter of 2015, according to hedge fund data firm HFR. Demand from institutional investors has been the main driver of this growth, with experienced hedge fund managers having proven track records benefiting most. The boost in allocations to hedge funds (+28%) helped the asset class achieve parity with private equity funds (-27%) last year, according to the EY 2021 Global Alternative Fund Survey.

"Throughout 2021, the alternative fund industry has proven its ability to weather economic volatility and manage risk while producing returns that meet or exceed investor expectations," state the report authors.

The South African hedge fund industry has seen similar strong demand patterns throughout 2021, and this momentum has continued into 2022. According to annual hedge fund statistics released by ASISA, the local hedge fund industry grew assets by nearly 19% to end 2021, to reach R86.93bn under management, as more investors saw the value of hedge fund strategies. While institutional investors have led the increase in allocations, the emergence of FSCA regulated retail hedge fund products has also attracted strong demand from retail investors.

Hedge funds aim to deliver superior risk-adjusted returns regardless of market conditions. Rising volatility and divergent performance across asset classes create a larger opportunity set for hedge fund managers to exploit. Having access to multiple asset classes, diverse geographies and short selling strategies also provides a broader toolset, which can be used by astute hedge fund managers to protect investors' capital when markets fall and grow their wealth in more turbulent times. The addition of select hedge fund investments to a portfolio can offer fantastic diversification benefits and reduce correlation to overall equity and bond markets.

As with any investment decision, selecting the correct hedge fund investment should consider the track record of the manager, the longevity and repeatability of the investment process, the risk profile of the underlying fund, the depth of experience of the investment team and the alignment of interests between the managers and the investor. The formal regulation of hedge funds in South Africa and the emergence of retail hedge fund products has enhanced investor protections and dramatically increased the accessibility of these products for the average retail investor.

In an opaque global environment where high inflation, rising interest rates and extreme volatility in equity and bond markets is set to persist, astute investors will actively seek out investments to protect and grow their purchasing power over the coming years. Uncertain and unusual times often warrant a rethink of long-held beliefs. It is with this in mind that we believe investors should consider adding select hedge fund products offered by reputable managers to their portfolios.