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THE BIRD'S EYE

NOVEMBER 2022 | EDITION 2

A WARM WELCOME FROM OUR CEO JACQUES CONRADIE

Welcome to the second edition of The Bird's Eye, Peregrine Capital's bi-annual newsletter where we share our views and news about our business, our funds, and why hedge funds should form part of a growing and diversified investment portfolio. In addition, we will share our perspective on quarter 3 of 2022, following on from our review of the first 6 months of the year which we shared in our **Semi-Annual Investor Letter** that was shared in July.

We share regular updates and insights on our LinkedIn page – please **follow us** to keep up to date with what we're working on as we continue in our mission to create wealth for our clients.

2022 has been an exceptional year for all the wrong reasons. While it has been a good year for Peregrine Capital, it has been a very difficult year for the world. We are dealing with our first major war in a very long time and also, for the first time in around a decade or so the world is having to face increased interest rates, in developed markets and emerging markets alike. This has caused an extremely difficult environment for global markets and made it challenging for most investors to protect their capital and generate strong returns. As of the end of September, the JSE all share index is down by more than 10%, with a multi-asset high equity category down about 7%. Globally, things have been much tougher. The S&P 500 is down about 25% year-to-date, with the Nasdaq down 33% as of the end of September.

It is really a great time right now to be managing a hedge fund. We have got a wide toolkit available to generate returns for investors under various circumstances and I can assure you that the toolkit is being put to its full use right now to generate great absolute returns.

CLICK TO VIEW AN INTERVIEW WITH JACQUES ON THE YEAR TO DATE.

WATCH HERE

PEREGRINE CAPITAL'S QUARTERLY FUND PERFORMANCE REVIEW

Matthew Thomson, Portfolio Manager at Peregrine Capital reviews how the market impacted the funds during quarter 3 for 2022.

We continued to witness significant volatility across equity and bond markets in Q3, as 2022 continues to shape up as one of the most volatile years that we have seen in a long time. After initially increasing 11% in the first half of the quarter, the MSCI World Equity index retreated significantly to end the quarter down 6%. The JSE Capped SWIX Index was also not spared, ending down 2.3%. While evaluating performance over such short time periods is often fraught with randomness and bias, we are pleased to have delivered positive returns for our investors in our Hedge Funds when the backdrop was clearly negative for risk assets globally.

While we pride ourselves on detailed bottom-up fundamental analysis, there are periods when macroeconomic variables cannot be ignored. The combination of COVID-19 lockdowns and hangovers, loose monetary policy in the US and Europe, supply chain disruptions, geopolitical tensions between the US and China, localisation and protectionism, the lack of investment in new energy supply and the war in Ukraine have sparked the highest levels of inflation that the developed world has witnessed since the 1970's. In times of higher inflation, central banks increase short term interest rates to cool demand and bring inflation under control. During the quarter, the yields on short term Treasuries increased by more than 1.2%, highlighting the backdrop of the US Federal Reserves resolve to fight inflation with tighter monetary policy. The combination of higher inflation and rising interest rates negatively influences the revenue, operating costs and finance costs reported by companies we invest in, resulting in lower earnings. In addition, rising long term interest rates cause higher discount rates, resulting in lower asset prices. The severity of the negative impact differs depending on the company in question, and it is incumbent upon us to identify opportunities that benefit within this macro backdrop. In sum, top-down drivers are directly influencing bottom-up fundamentals.

At a portfolio level, our net exposure remained broadly stable throughout the quarter. Current net exposure for the High Growth Fund is at its lowest levels in many years and we have actively prioritised pair trades as a means of generating alpha in this environment. What is clear in the current macro backdrop is the high correlation of assets across the board, which has led to declines is seemingly "safe-haven" assets such as Government bonds and Gold along with equities. We have actively found investments that are uncorrelated to these macro themes, and hence remain excited about our portfolio positioning at present.

CLICK TO VIEW OUR FLAGSHIP FUNDS' THIRD QUARTER PERFORMANCE BELOW:

PEREGRINE CAPITAL HIGH GROWTH H4 Q1 HEDGE FUND

Click above to view why you should continue to invest in Peregrine Capital's High Growth Fund - the first fund in South Africa to achieve 100X* an investor's initial investment, so R1 million invested in the fund in February 2000 is worth more than R100 million now.

*Please refer to disclaimers at the end of the newsletter.

PEREGRINE CAPITAL PURE HEDGE H4 Q1 HEDGE FUND

Click above to view the factsheet of the longest running hedge fund in South Africa, designed to offer investment stability and downside protection while growing investors' purchasing power. The fund aims to deliver returns above inflation over the medium term and has never had a negative year since its inception in July 1998.*

*Please refer to disclaimers at the end of the newsletter.

WHY HEDGE FUNDS SHOULD BE PART OF YOUR INVESTMENT PORTFOLIO

MORE TOOLS IN THE SHED – A CASE STUDY ABOUT "THE NASPERS DISCOUNT"

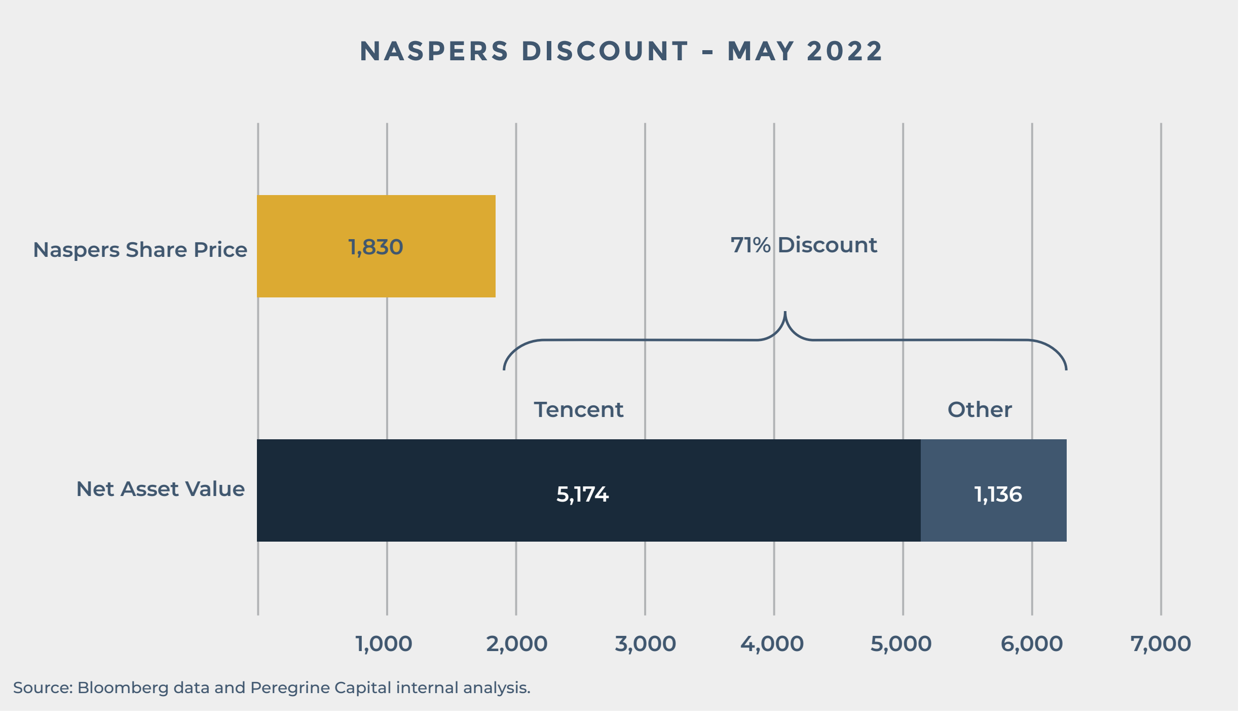
Justin Cousins, Executive Director and Portfolio Manager

We often talk about how hedge funds have more investment "tools" than more traditional long only funds do, and in this instalment of the newsletter we thought we would use the example of Naspers to demonstrate how we are able to extract value from an opportunity without having to take a directional view on the underlying company.

Short selling is typically associated with "betting against a company" or "exposing fraud". While these are certainly strong motivations to engage in short selling, there are a host of other reasons why a hedge fund manager might use this tool to generate returns. One of the most common motivations for engaging in short selling is arbitrage trades that attempt to take advantage of holding company discounts. Naspers and Prosus serve as the perfect example to demonstrate how we engage in such trades to generate returns for our investors. The value of this tool is that it allows us to generate returns for our funds that have no reliance on the market (or even the underlying share price) going up. For this discussion, we will refer to both Naspers and Prosus as "Naspers", as these entities reference the same underlying assets.

Naspers is an investment holding company that owns a significant interest in Tencent, the gaming and social networking giant in China. Tencent has been the jewel in the Naspers crown for many years, propelling Naspers to the top of the list of the most valuable companies on the JSE. Unfortunately, Tencent's success eventually became a burden for Naspers, as it grew so large that is accounted for 25% of the JSE's total market capitalisation. The better Tencent did, and the larger Naspers grew, the wider the discount to the underlying assets became. When we undertook our due diligence on the company for the first time, the discount to the underlying assets was approximately 20%. As the years passed, the discount got ever wider, eventually reaching a peak of 71% at Naspers. At that time, there was approximately $100bn worth of trapped value between Naspers and Prosus and investors had just about given up hope.

The Naspers management team has been aware of this significant problem for the better part of the past six years given the persistent pressure from shareholders to find a solution for the discount. They engaged in several transactions that were aimed at structurally solving the discount, but their actions made the situation progressively worse, resulting in an ever-wider discount. Matters went from bad to worse earlier this year when Russia invaded Ukraine. In addition to being forced to write off or sell their interests in Russian assets VK and Avito, shareholders concluded that Naspers exposure to China and Russia presented unacceptably high risks and proceeded to sell Naspers shares indiscriminately. It was at this point that the discount to the underlying assets at Naspers reached its peak level of 71% in May 2022.

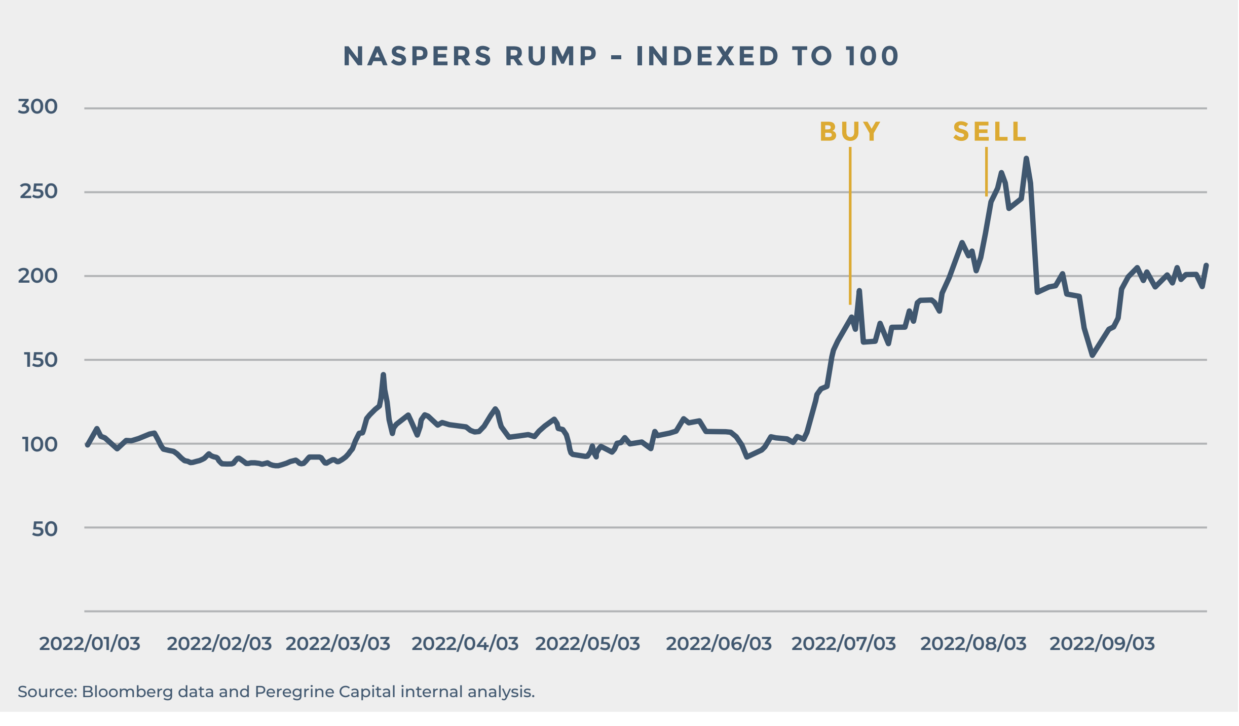

NASPERS DISCOUNT - MAY 2022

Source: Bloomberg data and Peregrine Capital internal analysis.

Back in 2018, Peregrine Capital wrote to the board of directors of Naspers, advocating for a series of transactions whereby Naspers would sell Tencent shares and repurchase Naspers shares. This transaction was effectively a risk-free way to continuously sell Tencent at its market price and immediately repurchase those same Tencent shares (via Naspers) at a 40% discount to the underlying asset value at that time. By selling an asset for 100% of its value and immediately repurchasing that same asset for 60% of its value, Naspers had an incredible risk-free opportunity to accelerate per share value growth for Naspers shareholders by exploiting the wide discount. It is our firm belief that the discount is out of management's control but presents an incredible opportunity to accelerate per share value growth in the manner described.

While our letter was disregarded in 2018, the Naspers management team, to their credit, dusted off this solution and announced an open-ended share repurchase programme of Naspers and Prosus shares, funded by the disposal of Tencent shares on the 27th of June 2022. The result of this announcement was the immediate narrowing of the holding company discount. While the announcement was positively received by the market, the discount persisted at very high levels for two days following the announcement of the transaction. While we missed the first move upwards, our team was convinced that there was further narrowing of the discount to come, especially if management used their self-proclaimed "bazooka" in the weeks following the announcement.

Rather than simply buying Naspers shares, we used our ability to "short sell" to construct a trade that gave us exposure to all Naspers assets, other than Tencent. Mechanically, we purchased Naspers shares and short sold the Tencent shares against the Naspers shares we owned. This trade gave us direct exposure to the highly undervalued "Naspers rump assets", allowing us to benefit from a narrowing of the discount when it was at approximately 55%. We were not forced to take a company specific view on Tencent, which has been navigating choppy regulatory waters in China. We knew that the wider the discounts became, the more shares Naspers could repurchase with their Tencent sales proceeds. We also knew that Naspers would be buying our long positions and selling our short position, so the technical supply/demand dynamics were in our favour. Our funds were able to generate low risk returns of approximately 20% on this trade as the Naspers discount narrowed to 40% over the coming months.


NASPERS RUMP - INDEXED TO 100

Source: Bloomberg data and Peregrine Capital internal analysis.

The Naspers example demonstrates very clearly how short selling can be used to neutralise exposure to a component of a company that you don't like. Instead of adding more market risk by buying Tencent within Naspers, we were able to neutralise the Tencent exposure by short selling the Tencent exposure within Naspers. It is important to emphasize that this sort of opportunity is not generally available to managers of long only funds. For the average long only fund, benefitting from the Naspers discount reduction requires that you own Naspers, forcing you to take a specific view on Tencent. Hedge funds have the flexibility to simply not to have a view, which is an incredibly valuable tool to have at one's disposal in this type of market environment. Arbitrage trades aimed at taking advantage of holding company discounts have proved to be a highly effective and differentiated means of generating returns for our investors as a hedge fund manager.

WHY HEDGE FUNDS?

WHAT IS THE DIFFERENCE BETWEEN UNIT TRUSTS AND HEDGE FUNDS?

CLICK HERE TO FIND OUT MORE

HIGH GROWTH FUND VS JSE CAPPED SWIX INDEX

South Africa's first fund to deliver 100x* initial investment, Peregrine Capital's High Growth Fund has outperformed the JSE Capped SWIX index by 10 times over the past 22 years. Click here to follow its journey.

*Please refer to disclaimers at the end of the newsletter.

CLICK HERE TO FOLLOW IT'S JOURNEY

HOW HEDGE FUNDS ARE ENTERING THE FINANCIAL ADVICE SPACE. – AN INTERVIEW WITH ALAN YATES

Hedge funds are making their way into the retail financial advice space. What does this mean and how are they gaining traction?

CLICK HERE TO LISTEN TO THE INTERVIEW.

PEREGRINE CAPITAL IN THE NEWS

City Wire Deputy Editor, Stephen Cranston, interviewed Jacques Conradie about how hedge funds offer investors higher returns and lower drawdowns than traditional long-only portfolios. They also discussed how hedge funds should appeal more to conservative, risk-averse investors than conventional unit trusts.

READ THE ARTICLE

Simon Brown, Presenter of the Moneyweb Now podcast, interviewed Jacques Conradie about how to find companies that are the most mispriced. Jacques discussed how to find winners where the market isn't looking for superior returns.

LISTEN TO THE INTERVIEW

PAST EVENTS

INDUSTRY EVENTS WE PARTICIPATED IN THAT YOU MAY HAVE MISSED:

INVESTMENT FORUM 2022

Jacques Conradie presented under the topic "Digging for Diamonds – a dive into some of the JSE's less obvious winners" and took part in a panel discussion where he discussed the reasons why Emerging Markets have underperformed (when compared to Developed Markets) in the past decade and shared our views on the outlook for the years ahead.

SEE MORE

GLACIER INVESTMENT SUMMIT 2022

Peregrine Capital's Jacques Conradie took part in a panel discussion centred on how themes should not be approached on face value. He discussed hedge funds as the asset class for the future and shared a brief synopsis of how our funds have added to performance while reducing risk and correlation. "We know that technology and ESG are themes that will be prominent into the future, but deep-dive research on them and the stock-picking that follows, is crucial," said Jacques.

SEE MORE

2022 INVESTMENT THINK TANK

Peregrine Capital had the pleasure of presenting at the Investment Think Tank conference and meeting with IFAs in Durban, Potchefstroom, Bloemfontein and Gqeberha. Matthew Thomson presented on some of our recent share ideas that have contributed to strong performance for our clients.

The event included interesting discussions with moderators and the audience, on how hedge funds can add significant value to client portfolios, especially in the current turbulent environment.

SEE MORE

PEREGRINE INSIDER

We recently hosted a series of events around the country for Financial Advisors who were invited to join our Portfolio Managers to discuss our portfolio positioning, hedge strategies and the opportunities we think will generate great returns for our funds set against the macro challenges we are seeing in the market.

VIEW HIGHLIGHTS

UPCOMING EVENTS WHERE YOU CAN MEET THE PEREGRINE CAPITAL TEAM

Look out for Peregrine's in-person Investor Day in Johannesburg and Cape Town.

FEBRUARY 2023

FIND OUT MORE

PEREGRINE.CO.ZA

CONTACT US ABOUT INVESTING, TODAY.

Peregrine Capital (Pty) Ltd is an authorized FSP

*100X refers to the Peregrine Capital High Growth H4 QI Hedge Fund. R1m invested at inception is worth more than R100m today. The FTSE/JSE Capped SWIX generated R12,5 million while the SA Multi Asset - High Equity Category generated R8,8 million. (High Growth Fund annualised return: 23.72% | SA Multi Asset - High Equity Category annualised return: 10.09% | FTSE/JSE Capped SWIX annualised return: 11.80%, all since inception (February 2000)). Data to 30 September 2022 | Source: Peregrine Capital, IRESS, Bloomberg.

Full disclosures