

This Review¹ has been published since December 2003. For previous reviews, please visit www.nedgroupinvestments.co.za or, for further information², contact Mohini Naidoo at mohinina@nedgroupinvestments.co.za.

The funds participating in the Nedgroup Investments Hedge Fund Review gained, on average, 1.5% after fees during May. The long/short equity category was the best performing category for the month, delivering 3.3% on average. The funds in the fixed interest, market neutral and trading categories, on average, achieved returns of 1.6%, 1.0% and -0.3% respectively. The trading category also produced the widest dispersion of returns for the month ranging from -6.0% to +7.0%.

For the 12 months ended May 2007, the hedge funds with long enough track records delivered 22.1% on average. Over this period the long/short equity funds also achieved the highest returns of 39.2% on average. The fixed interest, market neutral and trading categories delivered returns of 11.8%, 9.4% and 21.2% respectively. The fund with the highest return for the 12 months ended May 2007 was the Vega Centauri Fund Composite with a return of 67.8%. By comparison, the FTSE/JSE All Share and the All Bond Indices returned 42.9% and 6.0% respectively over the same period.

There are now 47 funds contributing to the Review, and 49 to the Nedgroup Investments Hedge Fund Index. The Genesis Hedge Fund managed by Stephen van Schoor and Stephen Murefu is a new entrant to the Review this month and is classified in the trading category. The Cadiz Malachite Fund (previously in the fixed interest category) was closed and investors' money returned following the resignation of the fund manager, Dr Linda Smit. There are now two remaining funds participating in the Review in the fixed interest category.



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2. This publication provides factual historical information about the performance of the listed funds only, as received by the respective asset management houses and relied upon by Nedgroup Investments. It is not an invitation to invest in any of these funds.

Asset management house	Fund name	Inception date	Maximum total gross exposure	Open for new money?	Fund size in R/m	1 Month Return to 31/05/2007	YTD Return	1 Year Return to 31/05/2007	Rank	Annualised 2 Year Return to 31/05/2007	Rank	Standard deviation over last 24 Months	Sharpe Ratio	Rank	Sortino Ratio	Rank
Fixed Interest opportunities category:																
Coronation	Granite Fixed Income Fund	Oct-02	1000%	Yes	371.6	1.0	5.0	11.9		12.2		1.3	3.4		18.9	
PSG Absolute Investments	South Easter Fixed Interest Fund	Nov-05	1200%	Yes	59.1	2.1	4.9	11.6		n/a		n/a	n/a		n/a	
Average - Fixed interest opportunities						1.6	5.0	11.8		12.2		1.3	3.4		18.9	
Long/short equity category:																
36ONE Asset Management	36ONE Hedge Fund	Apr-06	200%	Yes	400.0	5.3	25.1	58.6		n/a		n/a	n/a		n/a	
Armin Diem for Alpha Macro Fund Managers Pty Ltd	Absolute Alpha Fund	Nov-03	150%	Yes	70.6	1.3	9.1	32.1		41.2		13.3	2.2		6.7	
BlueBay Fund Managers	Mayflower Fund	Oct-03	350%	Yes	1026.0	5.4	21.4	33.2		35.4		9.5	2.6		5.4	
BoE	BoE Alpha Fund	Jan-07	200%	Yes	36.0	2.4	27.3	n/a		n/a		n/a	n/a		n/a	
Cadiz	Emerald Fund	Jul-06	300%	Yes	40.0	4.5	19.1	n/a		n/a		n/a	n/a		n/a	
Catalyst Fund Managers	Catalyst Alpha ECP	Feb-06	700%	Yes	18.0	9.6	26.3	45.1		n/a		n/a	n/a		n/a	
Clear Horizon Capital	Multi-Strategy Fund	Oct-05	500%	No	880.0	3.3	34.2	54.6		n/a		n/a	n/a		n/a	
Coronation	Presidio Fund	Oct-05	300%	Yes	32.1	0.5	6.6	22.6		n/a		n/a	n/a		n/a	
Investec Securities	IEB High Growth Portfolio	Jun-06	600%	No	723.0	6.4	42.9	n/a		n/a		n/a	n/a		n/a	
Mergence Africa Investments	Mergence Africa Hedge Fund	Jun-06	100%	Yes	100.3	1.8	16.6	36.2		n/a		n/a	n/a		n/a	
Oryx	Oryx LLP Fund	Nov-04	300%	Yes	1186.6	2.5	20.0	48.0		47.0		8.9	3.7		18.0	
Oryx	Oryx Segregated Fund	May-03	200%	No	539.3	3.5	21.9	51.1		51.1		9.7	3.7		18.3	
Peregrine Capital	High Growth Fund	Feb-00	500%	No	166.7	5.2	27.4	48.0		52.2		8.5	4.3		22.8	
Peregrine Capital	Performance Fund	Jul-98	500%	No	196.1	5.2	21.5	34.5		34.1		6.7	3.5		13.5	
Praesidium	Praesidium SA Hedge Fund	Dec-03	200%	Yes	348.1	1.9	16.9	39.4		32.6		4.6	4.7		21.0	
Taquantia	Taquantia Hedge Fund Composite	Dec-02	300%	Yes	1.6	1.3	2.7	5.6		10.0		5.8	0.5		1.1	
Umbono Fund Managers	Pentagon Fund	Aug-06	400%	Yes	1.0	-4.0	-2.6	n/a		n/a		n/a	n/a		n/a	
Average - Long/short equity						3.3	19.8	39.2		38.0		8.4	3.1		13.4	
Market neutral category:																
Allan Gray	Optimal Fund	Oct-02	200%	Yes	974.4	0.6	4.4	9.6		9.3		1.4	1.4		3.0	
Cadiz	Sapphire Fund	Nov-02	400%	No	487.0	0.4	7.8	16.1		15.7		5.1	1.5		3.3	
Coronation	Domestic Multi-Strategy Arbitrage Fund	Jul-03	300%	No	457.2	1.2	4.8	16.6		15.2		3.5	2.1		5.9	
Fairtree Capital	Fairtree Exchequer Fund	Jun-06	350%	Yes	209.0	0.9	5.3	16.2		n/a		n/a	n/a		n/a	
Fairtree Capital	Fairtree Market Neutral Fund	Oct-03	350%	No	407.0	0.0	4.2	12.4		18.2		5.1	1.9		5.4	
GP Joubert & Company	GPJ Segregated Hedge Fund	Jun-03	150%	Yes	17.8	4.2	7.4	21.2		19.0		6.1	1.8		4.6	
Gryphon	Alpha Fund	Jan-05	300%	Yes	9.0	-0.4	0.1	0.0		9.1		4.7	0.4		0.8	
Gryphon	Market Neutral Equity Fund	Jan-03	200%	Yes	80.0	0.6	0.8	4.9		8.3		2.6	0.4		0.6	
Huysamer Capital Investments	HCI Conservative Hedge Fund	Jun-04	160%	Yes	21.1	-0.2	0.9	6.2		5.4		2.8	-0.6		-0.9	
Investec Securities	IEB Absolute Return Portfolio	Jul-06	300%	Yes	81.0	5.5	29.3	n/a		n/a		n/a	n/a		n/a	
OMIGSA	Old Mutual Volatility Arbitrage Fund	Sep-05	133%	Yes	441.9	1.3	5.3	10.8		n/a		n/a	n/a		n/a	
OMIGSA	Select Equity Market Neutral Hedge Fund	Nov-05	133%	Yes	413.7	-0.7	3.9	10.5		n/a		n/a	n/a		n/a	
Peregrine Capital	Pure Hedge Fund	Jul-98	400%	No	129.3	3.9	15.8	23.4		22.1		4.0	3.4		25.1	
Stanlib	Quasar Fund	Oct-02	300%	Yes	1204.0	1.6	10.0	15.0		20.5		8.2	1.5		3.4	
T-Cap	Pardus Hedge Fund	Jul-05	300%	No	250.0	2.2	1.4	1.3		n/a		n/a	n/a		n/a	
Worldwide Capital	Ploutos Capital Fund	May-04	1000%	Yes	141.0	-5.4	-8.9	-22.8		-4.3		17.7	-0.6		-0.9	
Average - Market neutral						1.0	5.8	9.4		12.6		5.6	1.2		4.6	
Trading category:																
DWT Securities	Badger Quant Strategy Fund	Jan-04	500%	Yes	23.9	2.9	19.6	39.4		61.3		15.4	2.8		10.7	
Future Tactics	Garden Hedge Fund	Jan-04	200%	Yes	2.2	-2.3	8.6	20.2		22.8		11.3	1.3		3.1	
Genesis	Genesis Hedge Fund	Feb-06	800%	Yes	73.9	-3.6	2.7	1.7		n/a		n/a	n/a		n/a	
Gryphon	Doulos Fund	Jan-06	400%	Yes	10.0	2.4	9.6	12.6		n/a		n/a	n/a		n/a	
Interneuron	Freestyle Fund	Mar-02	100%	Yes	131.3	-0.7	8.7	18.9		25.2		11.6	1.4		3.9	
Rock Capital Management	Honey Fund	Jul-06	150%	Yes	7.7	-6.0	11.2	n/a		n/a		n/a	n/a		n/a	
Signal Futures	Signal Automated Fund	Aug-04	250%	Yes	5.1	1.6	6.6	10.9		30.4		20.5	1.1		2.4	
T-Cap	Isivuno Hedge Fund	Feb-05	300%	Yes	29.4	-2.6	2.3	11.3		6.1		9.7	-0.1		-0.1	
Top-Flite	Top-Flite Eagle Fund	Jan-06	500%	Yes	124.0	0.5	11.6	43.8		n/a		n/a	n/a		n/a	
Trendline	Trendline Diversified Fund	Jun-00	350%	Yes	96.8	-1.1	1.4	4.7		18.4		14.5	0.8		1.7	
Trident Capital	Trident Absolute Opportunities Fund	May-06	250%	Yes	102.5	-1.6	-1.5	1.8		n/a		n/a	n/a		n/a	
Vega	Centauri Fund Composite	Oct-04	300%	Yes	19.3	7.0	44.2	67.8		48.6		19.1	1.8		4.1	
Average - Trading						-0.3	10.4	21.2		30.4		14.6	1.3		3.7	
Notes:																
					Total:	12145.5										
						Average:	1.5	12.0	22.1	24.7	8.6	1.9	7.5			
(All returns are published net of fees. Both risk adjusted measures are calculated using the past 24 months' data)																
Market Indicators:																
FTSE/JSE All Share Index							1.7	16.2	42.9	48.0	12.4					
All Bond Index							-1.1	2.0	6.0	8.3	4.9					
STePI Interbank Call Rate							0.7	3.5	7.9	7.3	0.2					



What is merger arbitrage?

Merger or risk arbitrage exploits merger activity to capture the spread between the current market values of securities and their values in the event of a merger or restructuring. Most merger arbitrage managers consider cash-only, as well as share deals.

What is the relationship between merger arbitrage and distressed debt investing?

Both aim to capture price movements generated by large corporate events, eg mergers, corporate restructurings or liquidations, and are therefore sub-categories of the larger event-driven strategy. However, as the names indicate, merger arbitrage seeks opportunities relating to mergers and restructurings, whereas distressed debt searches for opportunities arising from pending or actual bankruptcy. Also, where merger arbitrage is usually a non-directional strategy, distressed debt is more directional (ie it has a higher exposure to market movements).

What factors do merger arbitrage managers consider?

The manager will analyse the probability of the deal closing, the bid price, and the timeframe to the closing date. If the deal involves a regulated industry, regulatory risk is also taken into consideration.

What would be a typical example of this strategy?

Take an example where the target company's shareholders are offered shares in the acquiring company. Say the offer is at a 10% premium to the target company's market price at the time of the announcement. Because of the 10% spread, it is expected that the target company's share price will appreciate, whereas the acquiring company's share price normally depreciates slightly (common in the case of megamergers) or remain relatively flat. Most merger arbitrage managers will therefore short sell the acquiring company's stock, and buy the target company's stock. Should the takeover realise, the share prices of the two companies converge, resulting in a profit for the hedge fund manager. The target company's shares are converted and the arbitrageur can deliver these to cover his short sale of the acquiring company's shares.

The contrarian manager, expecting the deal to fail, will short sell the target company's shares and buy the acquiring company's shares.

How is a cash offer handled differently from a share offer?

When the acquiring company's offer is in cash, the arbitrage manager would usually only buy the target company's share to benefit from the potential gain in the share price. With a share offer, as illustrated above, the manager also normally short sells the acquiring company's stock.

What kind of returns and volatility can you expect from this strategy?

This strategy usually delivers fairly consistent returns, compared to other hedge fund strategies. These returns can also be leveraged further by borrowing, but that would increase the risk of the fund.

What are the risks facing merger arbitrage funds?

This strategy is mainly exposed to deal or corporate event risk and equity volatility risk. In the illustration above, for example, the manager would stand to make a loss if the takeover does not realise, as the target company's share is likely to revert to its lower value before the announcement of the potential merger. Merger arbitrage is also called risk arbitrage, to differentiate it from pure arbitrage, which is risk-free. Historically, the vast majority of friendly acquisitions have realised. Even hostile takeovers are reasonably predictable.

Select bibliography:

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GLOSSARY

Absolute returns	Returns unrelated to, and independent of, any index measure of performance.	Standard deviation	The average fluctuation of a series of returns around its mean.
Asset allocation	Taking a view on whether domestic equity, bonds or cash, or perhaps offshore asset classes will be more likely to experience growth during the proposed investment term and allocating the fund's capital accordingly.	Short position	The seller sells shares he does not own on the calculated basis that before he must deliver the stock he will get the chance to purchase the shares at a lower price.
Fixed interest opportunities	These strategies attempt to capture mispricing within and across global fixed income markets and associated derivatives. Leverage is used to enhance returns.	Systematic trend following	These strategies take a directional view in markets based on computer models. The strategies reflect an emphasis on market trends and behavioral psychology.
Global-macro geared equity	These are strategies that employ a top-down macroeconomic approach to opportunistic investing globally. Managers will attempt to exploit changes in interest rates, exchange rates and liquidity for different instruments.	Sharpe ratio	This ratio measures the return of a fund, adjusted per unit of volatility. It is calculated by deducting the risk free return on cash from the fund return. The result is then divided by the fund's standard deviation.
Long/short equity fund	This is a broad category of strategies characterised by long positions in securities expected to appreciate in value together with short positions in securities (or derivatives thereof) expected to depreciate in value. It includes multi-strategy funds investing predominantly in equity markets.	Sortino ratio	This ratio measures the return of a fund, adjusted per unit of downside risk. It is calculated by deducting the risk free return from the fund return. The result is then divided by the fund's downside deviation from the risk free rate of return.
Market neutral equity	This usually involves being simultaneously long and short in matched equity portfolios of the same size within a country. These portfolios are designed to have no directional bias towards a potential bull run or a potential bear market.	Value investment	Value funds invest in shares with low relative price:earnings ratios, shares trading at a discount to their net asset values or shares with dividend yields significantly higher than the market average
Maximum total gross exposure	The sum of the absolute value of the long and short position exposure to the market.		