PEREGRINE CAPITAL

FREQUENTLY ASKED QUESTIONS

GENERAL QUESTIONS:

1. What is a hedge fund?

A hedge fund is an alternative investment portfolio, where the your money is combined with the money of other investors and the investment managers use the pool of money to buy and sell underlying investments in line with meeting the hedge fund's investment objective. In South Africa, hedge funds are managed under the Collective Investment Schemes Control Act (CISCA), in the same way as unit trust funds.

While traditional unit trust fund asset managers are only able take "long" positions, hedge fund managers are able to employ investment techniques like "short selling" to hedge risks or generate returns. In essence, hedge fund managers have more investment techniques that they are able to employ than traditional asset managers.

2. Are hedge funds risky investments?

Commenting about hedge funds as a homogeneous investment category is quite difficult. The investment philosophies and strategies employed by different fund managers vary greatly and give rise to different investment risk profiles. There are numerous examples of successful hedge funds in each strategy and product category, both locally and internationally. Every investment is risky in some way, so it is important that the investor consider the level of risk in relation to their specific appetite for risk.

As is the case with long-only collective investment schemes, more commonly known as unit trusts, hedge fund managers have different areas of expertise and competence. Because one fund can be so different from the next, investors should assess each hedge fund individually to understand the investment philosophy and process, the risk management procedures of the fund in question, and the extent to which interests are aligned between the investor and the investment manager.

Hedge fund managers do have the added ability to utilise short positions in their investment portfolios, which make it possible for them to generate returns, even when the market is experiencing negative volatility. The appropriate use of the tools available to hedge fund managers may result in smaller drawdowns and less volatility.

3. Are hedge funds regulated in a similar manner to other Collective Investment Schemes (Unit Trusts) in South Africa?

Hedge Funds in South Africa are regulated under the Collective Investment Schemes Control Act, 2002 ("CISCA"), which also regulates traditional long-only CIS unit trusts. Under the CISCA regulations, hedge funds are classified into Qualified Investor Hedge Funds ("QIF") and Retail Hedge Funds ("RIF"). The main differences between the two types of funds are:

	QIF	RIF
Minimum investment amount	R1 million	Set by the manager
Type of investor	The investor or the investor's financial adviser, must have demonstrable knowledge and experience in financial and business matters which would enable the investor, or the investor's financial adviser, to assess the merits and risk of a hedge fund investment	No restrictions
Dealing frequency	Not longer than three months	Not longer than one month

Investment limits	As determined in the signed agreements and hedge fund founding documents	As determined in the signed agreements and hedge fund founding documents, subject to the applicable legislation

4. Why should I include a hedge fund in my portfolio?

Hedge fund managers have been in operation in South Africa for more than twenty years and have long-standing, accurate track records. Regulatory pronouncements introduced in South Africa in 2015, include hedge funds in mainstream regulations, affording an additional layer of protection for investors. As such, investing in a hedge fund product is not dissimilar to investing in a traditional long-only CIS unit trust. Constructing a well-diversified portfolio of investments that can withstand various market cycles and generate suitable investment outcomes is important for every investor. Hedge fund investments typically provide return profiles that are less correlated with the overall market than the traditional asset classes, and can therefore be a useful diversifying addition to an investment portfolio.

5. Are there specific license requirements for an independent financial adviser or wealth manager to sell hedge fund products?

Yes, the financial adviser must be registered with the FSCA to provide financial services for the financial product "participatory interests in a CIS hedge fund", FAIS license category 1.26 and or 2.20, as per Annexure one and three of Board Notice 194 of 2017. (Refer to the Determination of Fit and Proper Requirements for Financial Services Providers, 2017).

6. What are some of the bigger misconceptions about hedge funds?

Market commentators often opine about how hedge funds are unregulated and that fees are not transparent. Recent regulatory pronouncements by the FSCA ensure that hedge funds are regulated in the same manner as traditional collective investment schemes. These regulations provide investors with more protections and enhance confidence in the hedge fund product offering. Regulations require detailed disclosures about hedge fund fees, ensuring that investors have full transparency when it comes to the cost of investing in hedge funds.

There is a preconception that hedge funds are more risky than traditional unit trust funds. As noted above in section 2, one should not judge the hedge fund space as a homogenous unit. It is possible for hedge funds to produce similar returns with a lower risk level than their long-only counterparts where the hedging "tools" are used to mitigate the fund's risk. Each asset manager/fund should be considered for its own worth.

7. Common investment terminology

Gross exposure

Gross exposure is the absolute sum of all positions, where the long and short positions are added together.

Net exposure

Net exposure is the sum of long positions, minus the value of short positions.

Short selling

Short selling refers to the practice of borrowing an asset to sell today in exchange for cash, with the expectation that its price falls during the investment period before repurchasing the asset and returning it to the original owner (the lender). Short selling can be undertaken for various reasons, including to hedge specific sector risks or to manage a fund's total market exposure. Short sales create leverage or gearing for the underlying fund, thereby amplifying investment performance.

Leverage

Leverage is the use of various financial instruments or borrowed capital, such as margin, to increase the potential return of an investment. Higher leverage can amplify investment returns, both on the upside and downside. Leverage includes the use of derivatives. Derivatives derive their value from the value of an underlying asset. The degree to which leverage may be employed within a hedge fund is limited by the investment mandate.

Volatility

Volatility, also known as the standard deviation of the fund's return, is a measure of how much a fund's return varies from its average over time.

Alpha

Alpha is a term used in investing to describe a portfolio's ability to beat the market return over some period of time. Alpha is often referred to as the "excess return" or "active return" on an investment and gauges the performance of an investment against a market index or benchmark that is considered to represent the market's movement as a whole.

Performance Fee

The Performance Fee is a variable fee that is dependent on the returns of the fund. In most instances there is a set participation rate, which is levied on the increase in net asset value (NAV), subject to the high water mark.

The High Water Mark

The High Water Mark ("HWM") refers to the highest point in value that the participatory interest has reached. The high-water mark ensures that the fund manager does not get paid a performance fee for the same performance twice. If fund loses money over a period, we must first make back this performance deficit and ensure that the participatory interest exceeds the HWM before charging the investor a performance fee. The HWM is updated at each crystallisation point.

QUESTIONS SPECIFIC TO PEREGRINE CAPITAL:

1. Are the investment managers invested in the funds alongside me?

Cumulatively, the investment management team and staff are a top five investor in our funds. As such, the interests of our investment management team are fully aligned with those of our clients. This sort of alignment is rare in the investment management industry and is something that truly differentiates Peregrine Capital from our peers. We share in the successes and experience the same losses that our client's experience.

2. What is Peregrine Capital's competitive advantage as a hedge fund manager?

Our competitive advantage as investment managers lies in our ability to identify superior and inferior business models and management teams, to estimate the expected return from those companies and instruments, and to rationally buy or sell securities according to those return expectations. We conduct detailed qualitative and quantitative assessments of companies we choose to invest in to enhance the degree of confidence we have in our investments. We do not limit our universe to our home market but are acutely aware of the advantages we have when assessing companies in South Africa.

We embrace situations that are complicated, difficult to analyse or that require considerable work as this often gives us an edge against competitors. We avoid companies where business models are excessively reliant on price movements relating to macroeconomic variables, as we do not have any competitive advantage in forecasting these variables. Although we are flexible with regards to the types of situations and companies we are prepared to invest in, our investment philosophy will always guide our decision-making process.

3. Can you explain the decision-making process within the investment team?

Our team conducts detailed research to obtain an understanding about each investable company or instrument within our investment universe. Two members of the team study each company or instrument within our universe to ensure ideas are robustly debated, risks are understood, valuation models are accurate and blind spots are identified. New ideas are proposed to the investment managers, who will debate the merits of the opportunity before taking action for the funds.

Our small team and flat hierarchy differentiate our decision-making process from that of large institutional investment managers. We are able to take bold decisions in a nimble and agile manner when opportunities arise as we are not constrained by excessive red tape and bureaucracy. Critically, all investment decisions are made in accordance with our investment philosophy.

4. Who owns Peregrine Capital?

75% of Peregrine Capital is owned cumulatively by the management and staff of Peregrine Capital. The remaining 25% is owned by Peregrine Holdings Limited, a private companyand financial services group focused on providing premier wealth and investment management services.

5. How do we think about Risk Management?

Our investment philosophy forms the foundation of our risk management process. We limit our investment universe to opportunities that we understand, where we can forecast earnings with a high degree of confidence, and where fundamentals are not excessively reliant on macro-economic variables. We prefer to take concentrated long positions in investments that we understand, but we maintain a well-diversified short book to manage risk.

We employ a centralised ranking tool that allows us to compare expected returns of various instruments, and we consistently assess position sizes relative to those expected returns. Our flat structure allows us to challenge each other respectfully without fear of reprisal and this ensures that the portfolio is always comprised of our best ideas. We do not speculate on currencies but rather manage our currency exposure within a pre-defined range.

6. What Socio-Economic Development does Peregrine Capital get involved in?

Peregrine Capital understands it has a role to play in advancing local communities through sustainable socio-economic development (SED) and empowerment programs. The Peregrine Group has a long-term strategy to empower communities. To date the SED initiatives have focused predominantly on education-centred projects.