

Top hedge funds outrun equities

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The top performing hedge funds in 2010 far outstripped equity fund returns in a year when the market slid sideways, and some managers are eyeing retail distribution of their products.

The NAOS Emerging Companies Long/Short Fund, overseen by 25-year-old portfolio manager Sebastian Evans, trumped its peers with a 56.5 per cent return.

The fund, which focuses on small and micro-cap firms unheard of by most investors, is being assessed by several ratings houses and hopes to have retail distribution by mid-year.

The NAOS fund and the second-ranked Mathews Capital Velocity Fund rely on intensive primary research and benefited from a strong run in small resources and small caps last year.

Many equity funds were held back by unremarkable returns from major banks, which comprise a large portion of the index.

Mr Evans said: "Our mantra is to rarely spend time in front of a computer but get in front of company managers – it's the only way to get a feel for the stocks you're investing in. We hold 20 stocks, as opposed to 50, so we know them more intimately."

His sentiment was echoed by the Mathews fund chief investment officer Ben Henri, whose fund posted 37.57 per cent last year and has average annualised returns of 46.47 per cent since its inception in 2007.

"Last year we made 450 company face-to-face contacts, the bulk with CEOs," Mr Henri said.

Mr Evans cited Vocus Communications, Macquarie Telecom and IPGA as performance contributors, while Mr Henri pointed to Arrow Energy, Bathurst Resources and Centennial Coal.

Australian Fund Monitors chief executive Chris Gosselin cautioned that, for many investors, risk-adjusted returns were an important consideration. This measure captures funds which provide the best returns for the risk taken and demonstrate low volatility.

The Regal Tasman Market Neutral Fund topped tables for best risk-adjusted returns last year and Mr Gosselin cited Hershel Asset Management and Fortitude Capital as other examples of consistent managers.

"A good manager will produce returns of 10 to 15 per cent per annum for a five-year period or longer with low volatility and low drawdowns [the difference between the peak and trough of returns]," he said.

"Fortitude had no negative months during the crisis in 2008 and Hershel has only a 6 per cent drawdown since inception in 2006 [with average annualised returns of 16.75 per cent]."

Mr Gosselin also noted that top performers all had relatively small amounts of funds under management, enabling greater concentration and diversification from an index.

Mr Henri said the \$81 million Mathews Velocity Fund had no near-term plans to close but noted the negative "law of large numbers" and its performance impact, while Mr Evans said the \$24 million NAOS fund would close at \$150 million.

Mr Evans's early interest in investing was encouraged by his ex-Macquarie broker father. He joined NAOS Asset Management as an analyst six months before the credit crisis. A number of stocks in the NAOS fund were highly illiquid at the time and did not have tangible assets on their balance sheets.

When the previous portfolio managers left, Mr Evans was promoted.

He overhauled the fund to focus on a smaller number of stocks, cut gearing levels of up to 250 per cent and decided to short the S&P/ASX 200 Index rather than individual stocks to focus on the long portfolio.

"We are a mix between a hedge fund and a long only fund, as we can hedge our equity market exposure. Our stocks may not necessarily have cash flow – you have lost 80 per cent of the upside once they start producing cash – but are likely to over the next two to three years," he said.

Mr Henri said the Velocity Fund was a long short strategy, which short sold index and commodity futures, as well as individual stocks.

Since inception in 2006, its lowest calendar year return was 8.64 per cent during the credit crisis in 2008.

Staff and management have a stake of about 15 per cent in the Velocity Fund, which has a one-year initial lock-

KEY POINTS

- The leading fund recorded a 56.5 per cent return in 2010.
- Hedge funds are increasingly eyeing the retail market.
- The top two both concentrate on personal contact with companies.

up to discourage short-term investors and a \$250,000 investment minimum.

The Regal Tasman Market Neutral Fund is also pitched at sophisticated investors with a \$250,000 minimum investment.

The fund maintains equal 50 per cent long and short positions to aim for returns uncorrelated to equity markets and does not use derivatives. It is likely to be made available to retail investors in the coming year.

Stars

Top three best hedge funds

Rank	Fund Name	Strategy	Investor Type	FUM* (\$m)	Latest 12-mths (%)	Annualised return (%)	Annualised standard deviation^ (%)
1	NAOS Emerging Companies Long Short Equities Fund	Equity long/short	Retail	23	56.50	20.60	28.41
2	Mathews Capital Velocity Fund	Equity long/short	Wholesale	81	37.57	46.47	34.22
3	Regal Tasman Market Neutral Fund	Equity market neutral	Wholesale	44	33.23	26.16	15.25

Top three best risk-adjusted return funds

Rank	Fund name	Strategy	FUM* (\$m)	Latest 12-mths (%)	Annualised return (%)	Annualised standard deviation^ (%)
1	Regal Tasman Market Neutral Fund	Equity Market Neutral	44	33.23	26.16	15.25
2	Bennelong Securities Long Short Equity Fund	Equity Market Neutral	159	12.72	22.34	12.24
3	Optimal Australia Absolute Trust	Equity Long/Short	55	13.64	18.20	3.91



*Funds under management ^Standard deviation is a measure of volatility

SOURCE: AUSTRALIAN FUND MONITORS

The Australian Financial Review

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