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HEDGE FUNDS

What four top SA hedge fund managers have learned from their mistakes

Some of South Africa's leading hedge fund brains reflect on turning bad experiences into good ones.

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Getting it wrong in fund management is inevitable. What often separates the very best managers from the rest, however, is what they learn from their errors.

Speaking during the Asset TV Alternative Investments Conference this week, four of South Africa's top hedge fund managers reflected on mistakes they have made and how they improved their process as a result.

Steven Hurwitz

Investment Analyst at 36ONE Asset Management

‘A big thing we’ve learned is that sometimes we’ve been too conservative,’ Hurwitz said.

‘We’re very focused on protecting client capital, and we did that well in March last year. But I don’t think we were aggressive enough in redeploying capital into the market.

‘We’ve learned that we need to be more balanced in our approach and understand there’s a risk sometimes of leaving money on the table.’

While this might seem easy to say in hindsight, Hurwitz said that, even in the market turmoil of the time, they should have been more aggressive when the balance of risks shifted to the upside.

‘There was a period after some of the dust had settled in March and April when the market continued to improve and you could see that some companies were net beneficiaries of Covid.

‘And with very little downside risk, you could have invested in these companies and done really well. We were invested there, but maybe we should have allocated more capital.’

Jean-Pierre Verster

Founder and CEO of Protea Capital Management

‘A lesson I have learned is that I am constantly surprised,’ Verster said.

‘I have a deep respect for the uncertainty of the future, and that we are often wrong.

‘We do analysis on our positions and realised that we are wrong roughly a third of the time, and right about two-thirds. That is why we build portfolios that are more diversified than average, so that when we are wrong it doesn’t hurt us too much, but we can still catch the upside when we are right.’

This, Verster said, is how a manager compounds returns over the long term.

‘I’ve learned that it’s okay to be wrong. We will be wrong. But by embracing that, understanding our biases and not anchoring to previous expectations, that’s how we stay flexible and don’t become dogmatic.’

Justin Cousins

Executive director and portfolio manager at Peregrine Capital

Cousins said that while Peregrine is committed to its bottom-up investment approach, they have learned it can carry the risk of ‘frog-in-the-pot syndrome’.

‘Two to three years ago we were perhaps not aggressive enough in shifting out of South Africa and into the more global opportunities where the fund is currently positioned,’ he said.

‘We were very focused on companies we know intensely well in South Africa, but failed to see the relative growth differential outside of the country.

‘So while we were accelerating our investment research into offshore companies, that process was perhaps too slow and cost our clients some returns in 2018 and 2019.’

The lesson learned is therefore to never take your eye off the bigger picture.

‘The risk of being bottom-up is that sometimes you fail to notice the top-down macro risk that might influence your portfolio. And the lack of growth in South Africa was detrimental.’

Matthew Pouncett

Assistant portfolio manager at Laurium Capital

‘One thing we’ve noticed through time is that we had a tendency to double down on losers,’ Pouncett said.

‘Effectively you buy a stock at a certain level, the share price goes against you, but you don’t change your view as you should.’

He said Laurium has worked hard at addressing this because it can be the hardest aspect of investing, when you buy a stock and it goes down. When this happens, it’s difficult to know whether you were wrong or the market is wrong.

‘Now when a stock drops to a certain level, we rotate the key analyst on that share for someone else to get a fresh view, because there is an inherent bias.

‘If you are the analyst who identified the opportunity, you are invested in that position and it’s difficult to be objective.

‘That’s something we have tried to refine and improve over time. You set an investment process and try to make it orderly, but you have to constantly do postmortems and refine that process by learning from past experience.’