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Altree Capital leads with strong Africa Opportunities performance

Celebrating five years of good returns, portfolio manager Jenni Chamberlain says her team's local market experience is key to the fund's consistent results

In its five years since inception, the Africa Opportunities Fund has produced solid performance, outpacing many other Africa funds against a difficult economic backdrop. Cumulative performance since inception is more than 50% (as at December 2011) versus the MSCI EFM Africa ex South Africa Index, which posted an 18% decline over the same period.

Jenni Chamberlain, portfolio manager for the Africa Opportunities Fund, attributes the success to knowing her way around Africa and having an unrelenting focus on the structural and operational inner workings of the African capital markets. "One of the primary drivers behind our consistency of outperformance is in-depth knowledge of local markets," says Chamberlain. "We have a very strong operational team that has worked throughout Africa for many years so we really do know the ins and outs. We've seen trades not settle and we've seen currencies move. Operationally, you have to be attentive to settlement, exchange rates and other costs as operational risk mitigation has helped us post generally stronger performance [than many funds in the market]."

Chamberlain has spent the past 14 years working in various investment banking and corporate advisory roles across most of the African capital markets. She has brokered numerous deals on the majority of African stock exchanges, which accounts for her knowledge of the practical regulatory and operational processes in the continent's major economies. From 1997 to 1999, Chamberlain was named Reuters top-ranked African research analyst. Prior to founding the Africa Opportunities Fund, Chamberlain served in a number of executive positions, including CEO of Securities Africa and managing director at HSBC. Whilst at HSBC, she served as member of the EMEA fundraising team and a member of the bank's corporate advisory team on capital restructuring and listing opportunities in Africa.

In June 2006, Chamberlain set up the Africa



Jenni Chamberlain

Opportunities Fund, which she manages with a focus on generating risk-adjusted absolute returns through investment in undervalued African and Africa-related securities. Chamberlain uses fundamental bottom-up analysis to guide her choice of stocks and build a portfolio with natural country and sector diversification. At US\$30 million, the fund has not yet reached the critical mass that Chamberlain is comfortable with. Over the next year, her objective is to grow it to US\$100 million and ultimately settle at a fund size of approximately US\$500 million to US\$750 million.

At present, the fund's primary sector weightings are banks (28.4%) and food and beverage (27.1%). It has lesser holdings in mining (12%) and telecommunications (5.9%). From a geographical perspective, the top four holdings are Nigeria (19.3%), BRVM (15.1%), Ghana (9.7%) and Kenya (7.1%). Having declined in line with the broader markets in 2008, the fund was steady in 2009 and rebounded in 2010 to finish the year 32.04% higher. In 2011, the fund ended 8.62% lower, a far stronger performance than the majority of Africa funds and the broader indices.

Chamberlain points out the natural diversification of Africa and the limits she adopts

within the fund. "From what I understand, we run a more diversified portfolio than most of the other managers in our peer group," says Chamberlain. "Where some can have up to 45% exposure to Nigeria, as an example, we cap exposure to any one country at 25%. Africa is a rather large place and if you have more than a quarter of the fund's exposure invested in any one country, performance is likely to suffer as the result of over-concentration and opportunity cost given the continent's many diverse investment opportunities. Diversification is one of the natural benefits inherent to investing in Africa and we try to take advantage of that. It has certainly helped us in periods of prolonged market weakness."

The Africa Opportunities Fund follows six core investment themes. Africa's fundamental growth prospects is one – since 1990 many of the continent's leading economies have lowered inflation, reduced debt and trimmed budget deficits. Resource strength is also key as Africa maintains 60% share of the world's uncultivated arable land and is home to 80% of new resource discoveries since 2007. The continent's social and demographic profile is another well-known theme as Africa's working-age population will rise to 1.1 billion by 2040, making it the largest work force in the world. On the back of this, there will be opportunities to profit from increased urbanisation and rising levels of productivity. Finally, increased democratisation has resulted in reduced political risk and declining incidence of corruption. Thus, the stage is set for improved conditions and greater foreign investment.

Chamberlain does, however, acknowledge the dichotomy of Africa's performance. "There are two ways of looking at Africa. If you look at it from an economic and GDP growth perspective, it has done extremely well. Yet from an investment perspective, African equity market performance has been somewhat uninspiring," she says.

For a long time the continent's fundamentals have been in place – high GDP growth rates, di-

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minishing deficits, and greater political stability. And for a period, investors believed the African capital markets to be a non-correlated asset class. But that was before the global financial crisis exposed many emerging and frontier markets as having higher betas than otherwise indicated.

Chamberlain acknowledges that it's been a tough few years for Africa. "During 2007 and 2008, we saw huge sums of money invested in these very illiquid markets as many investors had the perception that Africa was not correlated," she says. "Yet when systemic events occur, market correlations tend to converge and the African capital markets were no exception. During the post-crisis period, we saw money move away from all asset classes and the African equity markets suffered significant losses due to their relative illiquidity. Africa funds struggled as investors cut risk aggressively."

Chamberlain describes a lag effect in Africa as it takes some months for bad news to filter through to Africa's local markets. This is further magnified by overall market illiquidity as it can take several more months for redemptions to be completed and investors to exit funds. Describing the lag effect, Chamberlain says: "A clear example is Ghana, which was the world's best performing stock exchange in 2008 as relatively illiquid trading conditions prevented investors from exiting positions in size. Needless to say, Ghana emerged as the worst performing stock exchange in 2010."

To effectively manage overall market uncertainty, Chamberlain has instituted a methodical investment process, which broadly constitutes idea generation, corporate due diligence, portfolio management and risk maintenance. The research team behind the fund is responsible for idea generation within the identified investment themes. Research analysts test the viability of an investment idea, review financial statements, build and update in-house research models, and stress test preliminary entry and exit points. Corporate due diligence is performed, including management calls, onsite visits and third-party meetings with key vendors and suppliers. A formal assessment is completed, financial models are refined, and Chamberlain updates entry and exit points in line with prevailing market conditions.

Portfolio management is an iterative process that constitutes a thorough review of investment performance simulated across a range of company, sector and country-specific scenarios. When attempting to assess prevailing macroeconomic conditions, Chamberlain benefits from the depth of her advisory board, which includes such notable figures as Thomas Gibian and Todd Moss. Gibian is the founding principal and non-executive chairman of Emerging Capital Partners – the award-winning African private equity house with nearly US\$2 billion in assets under management. Moss is vice-president and senior fellow at the Center for Global Development (CGD) where he directs the economic policy think tank's Emerging Africa Project. Prior to his role at CGD, Moss served as Deputy Assistant Secretary for Africa at the U.S. State Department.

Chamberlain notes that risk management is vital to the success of any Africa fund. The

team carefully manages counterparty risk with banks, brokers and service providers, ensuring compliance with exchange-rate rules and limits whilst monitoring financial events and individual price movements.

Describing the misconceptions about Africa that still persist, Chamberlain says: "Perceptions are that Africa is a very risky political jurisdiction to invest in due to changes in government and changes in regulation. There is also this misconception that if something negative happens in one country, contagion will cause it to spill over into other countries."

She remains upbeat on Africa's prospects, referring to the "triple effect". "We are very positive on the long-term prospects for Africa," she says. "We think that we are likely to see the triple effect of appreciating currencies, equities and bonds as these economies grow over time."

Although housed within a hedge fund structure, the Africa Opportunities Fund is more of a long-biased Pan-African equity fund. "We do not follow a hedge fund mandate in terms of trying to pair our long and short positions because securities lending is not really possible in African markets," says Chamberlain. "We intentionally structured the fund within a hedge fund structure so as to provide increased flexibility and take advantage of market opportunities as they arise. As the African capital markets develop, we believe there will be opportunities to leverage our in-house research methodology and proprietary investment process on the short side. Again, we are a fundamental bottom-up research house so any short selling must be justified from a valuation perspective. Certainly, our long-term perspective on Africa translates into a portfolio that would naturally be long-biased. That said, our investors look to us for risk-adjusted absolute performance and we need to take advantage of arbitrage opportunities as they arise."

When such opportunities arise, Chamberlain will use them to enhance returns. For example, one particular opportunity that she was quick to capitalise on was in the first half of 2009, when the fund invested in Nigeria's Guaranty Trust Bank (GTB) Eurobond when it was trading at a 62% yield to maturity in US dollars.

"Uncertainty led to depressed price levels so we put on a nice sized position in GTB and sold the bonds with a yield to maturity of 12%," says Chamberlain. "We then switched into a credit-linked note for another Nigerian bank that was trading on a yield to maturity of 33.5% at the time. All of these bonds were priced in dollars and they each held an effective sovereign guarantee which further limited

downside risk. We happened to know the aforementioned banks well because we held the underlying equities in our portfolio. As such, we were pretty comfortable with the related company-specific risk. Looking back, it was an easy decision for us to reduce our equity exposure and add Nigerian bank bonds yielding 62% in US dollar terms over a two- to three-year period."

Reflecting on the fund's performance in 2011, Chamberlain says: "The fund generated healthy returns through the first half of 2011 despite a number of exogenous factors (e.g. the Arab Spring, Nigerian elections, Ivorian crisis, et al) which threatened to weigh down overall performance. Yet as the second quarter came to a close, the macroeconomic environment began to sour with inflation accelerating amid deteriorating investor sentiment. As a result, we reduced the fund's exposure to more volatile commodity-related holdings while increasing the overall cash position and employing a currency hedge aimed at protecting the fund's East African equity holdings. These decisions proved profitable and helped offset considerable market weakness through the second half of the year.

"As equity prices retreated further, we took advantage by adding to a number of existing positions at highly attractive levels. Looking ahead, we believe the fund is well positioned heading into 2012 amid strengthening fundamentals and improved growth prospects," she says.

Besides Chamberlain, the fund has three Africa-based research analysts; two in Harare and one in Johannesburg. They all travel extensively to review and meet with the management teams of African companies. The operational team is primarily based in Bermuda and led by the firm's chief operating officer. "We find it works extremely well to have our back office in Bermuda," says Chamberlain. "We are four hours behind London and five or six hours behind Johannesburg depending on the time of year. This gives our operational staff a little bit of extra time to implement FX trades, send settlement instructions, wire funds, etc."

The Africa Opportunities Fund has been managed by Chamberlain and her team at Finch International Advisors since its inception in June 2006, with Finch recently spinning out its African asset management team under the name Atree Capital. By extracting the existing African asset management business and preserving it under a self-contained and segregated business structure with no change in ownership, Chamberlain believes the fund and its shareholders will benefit from greater structural efficiencies including implementation of an incentive scheme designed to attract best-in-class talent and better position the firm for continued expansion across Africa. This will also help the fund attract increased interest from investors across Africa, and South Africa in particular. "The one place where we haven't done a strong enough job is marketing to the African continent itself," says Chamberlain. "Africans tend to understand the risks associated with Africa far better than anyone else. That's something that we hope to capitalise upon moving forward."

FUND FACTS

Africa Opportunities Fund SAC Ltd.

Strategy: African equities, absolute return

Assets in strategy: US\$30 million

Managers: Atree Capital Ltd.

Fund inception date: June 2006

Administrator: Apex Fund Services Ltd.

Auditor: Deloitte & Touche

Open to investment: Yes

Minimum investment: US\$1 million