

THRIVE

STRIVING TO PRESERVE CAPITAL AND CREATE WEALTH YEAR ON YEAR

MARKET REPORT

EUROPEAN SOVEREIGN DEBT CRISIS CONTINUES

April saw flat performance from global equity markets, with the MSCI World posting a decline of 0.02%. The JSE showed similar performance, with a 0.06% decline. Performance was choppy throughout the month, with some sort of volatility returning to markets after a dramatic drop off the past few months.

Two stories dominated global and South African markets. Firstly there was the continuing sovereign debt crisis in Europe, with particular focus on Greece. Credit spreads on Greek bonds spiralled upwards during the month as investors expressed their uncertainty over the situation by demanding higher yields on their capital. By month end, an IMF bailout had been agreed, but for a much higher quantum (€110 billion) than had initially been thought necessary. Market reaction to the bailout however, was not what the European governments hoped and it seems like this is a story that will continue to dominate markets in May.

The second major story was the breaking news of Goldman Sachs' indictment by the Securities Exchange Commission (SEC) on civil charges relating to fraudulent conduct around a \$1 billion CDO known as "Abacus 2007-AC1". Essentially, it is alleged that Goldman Sachs sold this to clients without fully disclosing the nature of the securities and who had been involved in the construction of the CDO. In many

ways it is not the details of this indictment that spooked the market, but more the implications for the US banking sector as a whole. The Obama administration has made it clear that it will drive through financial reform with or without the support of the banking community and that it will look to clean up many of the suspect practices that were being followed. This has created major uncertainty as to the nature of future bank earnings, not just in the US. While Goldman Sachs' share price bore the brunt of the investor sell-off in the sector, other similar institutions also saw their share prices hit hard.

These two events overshadowed what was generally a continued improvement in company earnings and economic data. Essentially they have put two questions in investors minds:

1. Will there be contagion in the European debt crisis and is Greece merely the canary in the coal mine?
2. Will the SEC start looking at other CDO transactions from pre-credit crisis days that will bring more investment banks into the spotlight?

May should provide some more insight as to the answers to these questions. One thing that seems likely is that we will see the return of volatility after a number of months of very quiet activity and it would not be a surprise to see investors moving out of risky assets.

The Blue Ink funds produced the following performance to 30 April 2010

| | 1 Month | 3 Months | 6 Months | 12 Months | 2 Years | 3 Years |
|-----------------|---------|----------|----------|-----------|---------|---------|
| Big Oak | 0.52% | 2.14% | 5.59% | 24.34% | 6.71% | 17.72% |
| Blue Ink-ubator | 1.61% | 3.98% | 9.00% | 16.28% | 36.08% | 44.45% |
| Blue Sky | 0.84% | 2.05% | 3.57% | 10.71% | -4.07% | 5.18% |
| Evergreen | 0.98% | 3.54% | 6.37% | 12.90% | 20.98% | 30.78% |
| Redwood | 0.85% | 2.75% | 5.18% | 11.27% | 7.20% | 16.07% |
| ALSI | -0.06% | 8.21% | 9.76% | 41.77% | -1.23% | 10.52% |

Dear Clients



In this issue of Thrive, Walker Naude of X-Chequer Fund Management gives advice on hedge fund investing and chats to us about their investment strategy. X-Chequer currently manages two funds – a market neutral fund and a long/short fund. Blue Ink has been investing in the X-Chequer Long/Short Fund for the past 14 months and recently started investing in the X-Chequer Market Neutral Fund.

Proudly South African



We are proud to welcome the world to our country! Soccer, the "beautiful game", has united the world and excitement is reaching highs with less than a month to kick-off. Despite scepticism about South Africa's ability to host, we've done ourselves proud with stadiums being finished well ahead of schedule and logistical plans coming to fruition. It should be no surprise though when one considers the international events we've hosted successfully to date - ICC Champions Trophy (2009), FIFA Confederations Cup (2009), Indian Premier League (2009), World Twenty20 Championships (2007), not to mention the annual Nedbank Golf Challenge and Comrades Marathon. Unite Mzansi!

On the Blue Ink performance side, our conservative funds, Evergreen and Yellowwood are performing well in both the short and longer term. This performance is being achieved at relatively low levels of volatility. The Blue Ink-ubator fund, which identifies new manager talent pursuing alternative strategies, continues to perform well.

Until next month!

Esmarie Strydom

Chief Executive Officer, Blue Ink Investments

Debt Crisis, Banking Crisis, Market Crisis...Now Sovereign Crisis!

Opinion piece by Thomas Schlebusch - Chief Investment Officer, Blue Ink Investments



(3) *financial/investment market* ending in a market crisis in 2007/8, now widely compared to the events of the early 1930's.

World governments acted fast, pumping billions of dollars into their fragile economies and loosening monetary policies all over the world with "quantitative easing", in an attempt to stem economic slowdown, lay-offs and the market fall. However, by doing so, the private debt of individuals was effectively moved into the public domain by placing it onto government balance sheets.

In shifting the problem from one place to another, finance ministers argued that the problem would, at least for the short term, be contained. The debt and losses of the past years have now however, effectively been spread to the future, becoming the problem of future generations.

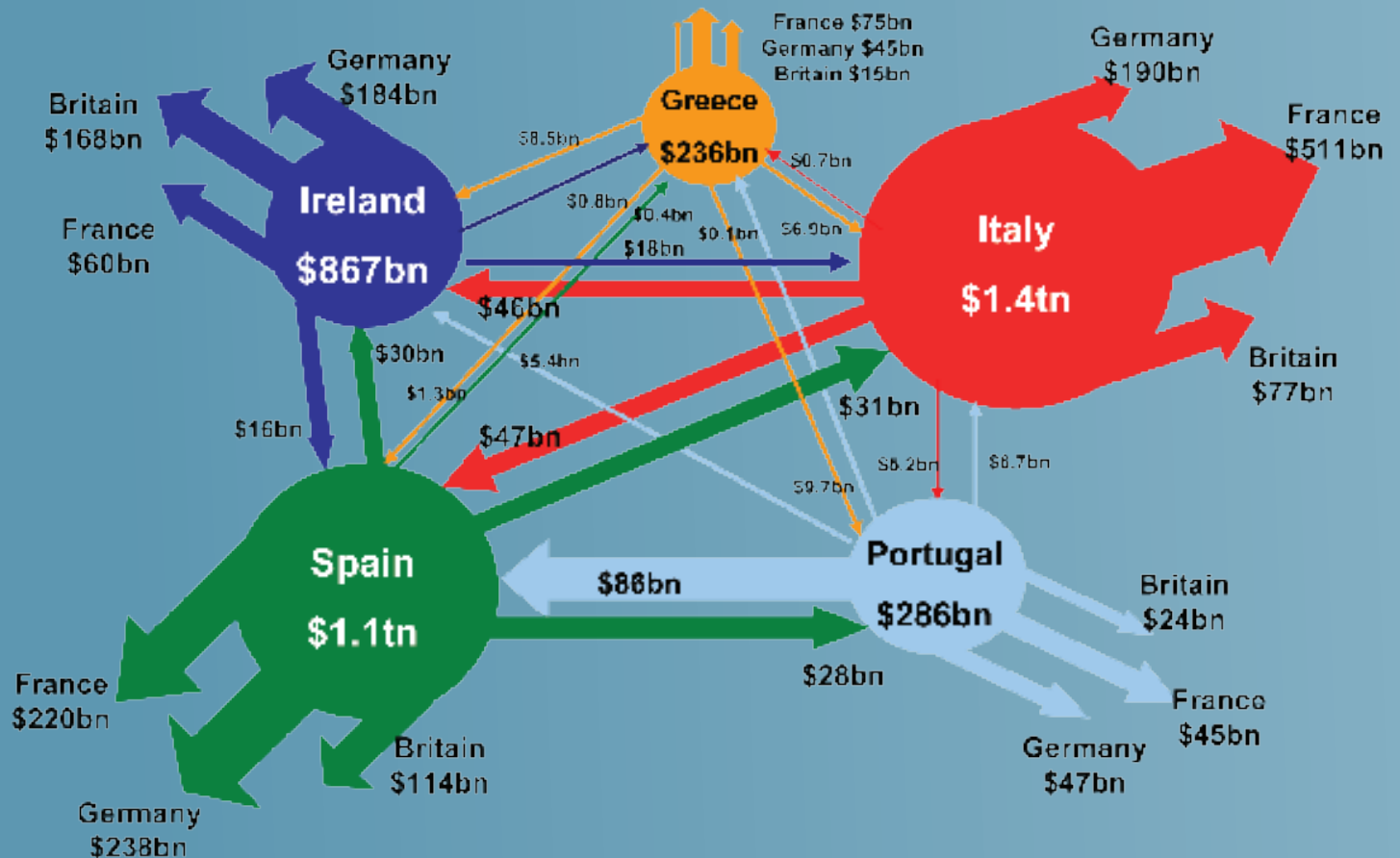


In New York, there is a "Debt Clock" at the Paramount building, which shows the average share of each US household's portion of the national debt. This clock, which is ticking up fast as interest gets added, stood at over \$170,000 per household at my last visit to the US in March 2010!

As I write this article, our fragile world financial system is still reeling from the aftershocks of events that started in the early 2000's (...and even earlier, some would say), again morphing into the next phase of the unknown.

What started as (1) a *debt bubble* finally showed itself in (2) a *financial bubble* affecting many global banks and insurance companies. The banking woes washed over into the entire

“ The debt and losses of past years have become the problem of future generations... ”



MARKET UPDATE CONTINUED

Naturally, opportunists such as hedge funds, have identified these trading opportunities, and one is not surprised to find that governments all over the world have zoned in on hedge funds as the guilty parties who's opportunism in unregulated environments has brought about the demise of stock markets and currencies across Europe.

The reality is however, that regulators are looking at the symptoms or results of the crises, as opposed to the causes there-of.

One therefore could not be blamed for being sceptical of the remedies being "fed" to address these symptoms and can't help wondering what the world will look like in the coming months and years. Of late there has been much talk (Pimco, et al) about the changing financial environment and it's "New Normal" with lower interest rates, more nationalism (rather than globalisation), more re-regulation (as opposed to de-regulation) and lower investment returns.

In light of our ever changing environment, I find myself wondering about the stability of the Euro-zone and the impact this will have on us, as well as the rest of the world. With this in mind, the crash of 2007 may still not yet be over and if the sovereign crises in Euro-land were to spill over to world markets once again, another drawdown may be just around the corner. There is however one truth that emerges more clearly now than ever... remain hedged! ■

FUND MANAGER PROFILE: WALKER NAUDE - X-CHEQUER FUND MANAGEMENT



How long has X-Chequer been investing in the hedge fund industry?

Our investment professionals have been investing in hedge funds since 2003 but X-Chequer Fund Management was established in 2007. We currently manage two funds. The X-Chequer Market Neutral fund was previously managed as part of a suite of funds at Fairtree Capital, where X-Chequer Founder, Werner Prinsloo was a co-founder and director. In June 2008, X-Chequer launched the X-Chequer Long/Short Fund. The current team has a combined experience of 32 years in the South African hedge fund market.

Where did you gain your experience and how long have you been in the industry?

I currently have about five years of specific hedge fund experience. My career began at BrockhouseCooper's where I was an investment consultant, specialising in investment manager selection. I furthered my knowledge by becoming a CFA Charter holder and Actuarial Science studies. My "sell" side experience as a stockbroker at Cazenove and Nedbank Capital, however, really entrenched my focus on hedge fund techniques. Over the years I have built various tools to analyse equity investments and have presented research ideas to both domestic and international long-only asset managers and hedge funds. In this time, I became a rated quantitative analyst in the Financial Mail. I gained valuable skills through exposure to strategies to help gauge asset allocation among various asset classes including sector rotation.

What motivates you about the hedge funds?

There are three major drivers. Firstly, hedge funds are able to grow real wealth over time, rather than just being a function of market behaviour or dependant on good equity returns. Two aspects differentiate hedge fund investing traditional investments: the ability to short sell and use gearing or leverage. With these tools, hedge fund managers are better equipped and have the ability to produce superior risk adjusted returns in the long run. Secondly, every day is a new challenge and I continue to learn new things daily. Lastly, by being an investment professional, I can on a day-to-day basis measure the value-add of my efforts which is truly rewarding.

What is your strategy or motto for investing?

We really understand the meaning of compounding and the importance of consistency. Using the following two examples of annual returns over a five year period - Investment A yielded annual returns of +50%, -11%, +20%, +25% and -15% while investment B yielded +15%, +15%, +15%, +15% and +15%. At first glance, it might appear as though investment A yielded superior returns with some really good numbers. The reality is however, that investment A resulted in a compound total return over the five period of only +70% while the more consistent lower volatility investment B, is up +101%. That's a more than 30% outperformance over a five-year period and equates to a significant six percent per annum gain. Therefore at XFM, we believe by protecting wealth on the downside and delivering consistent stable returns, we will outperform in the long run.

Our Long / Short Fund has had one monthly drawdown since inception of 0.7% while the largest monthly drawdown in the ALSI was 13.2% over the same period. More importantly, our Fund is up 68.5% since inception while equities are down 4.8% over the same period. This is mostly due to downside protection. Our Fund also has a much lower standard deviation of 6.1% compared to 22.9%, which demonstrates better consistency of returns.

What does X-Chequer do to differentiate itself?

A combination of our strong fundamental research and powerful proprietary quantitative tools and techniques sets us apart from our peers. A rigorous focus on money

management also helps to protect capital over all equity cycles.

Would you invest your own money in the hedge fund industry?

Yes, I am currently invested in our Long / Short fund and have my preservation fund invested in a product of another hedge fund operation.

How do you view hedge fund regulation?

I'm not an expert when it comes to the regulation, but it will be good see it move forward - it's been the cause of no flows to the industry. Regulation is always a bit of a double-edged sword - it's needed to protect and grow an industry, but it also introduces stumbling blocks and unintended consequences more often than not.

How does the SA hedge fund industry compare with offshore peers?

I think SA managers did an exceptional job during the recent credit crises. The industry was probably down single digits during 2008 (on an asset-weighted basis), and up around 10% in 2009. It shows how the bulk of the managers managed to preserve capital during this extreme event. Offshore funds suffered much bigger drawdowns, especially in 2008, when the bulk of the funds were down more than 20%. The SA market is a lot smaller than the foreign markets, and probably has fewer opportunities to grow - liquidity and funders of capital posing a big constrain to meaningful growth.

What advice do you have for investors?

First and foremost is to understand the value of investing in hedge funds, which should produce solid real returns over the medium term with lower volatility.

Then, when it comes to product selection, understand the objective of each strategy and how returns are generated, in order to better understand the risk profile of each manager. Hence meeting with managers is crucial. Finally, as hedge funds produce monthly survey data, opportunities may be forgone by chasing short-term performance. Rather, managers should be given a three-year time horizon to prove themselves and performance should be measured on a rolling twelve-month basis. ■



Chris Merritt Senior Software Developer at Blue Ink Investments

Tell us about your position at Blue Ink.

It is my task to take complex and cumbersome tasks and improve on efficiency and accuracy. The role is interesting in that one needs to satisfy the needs of many different role players by aligning development directions with the interests of clients. This is easier said than done because clients are not physically present in the development life-cycle, but are the ultimate benefactors of the improvements made.

How long have you been with the company?

I had an association with Blue Ink Investments more than 10 years ago, when I coded the client administration system for share-based portfolios. In 2008 I joined a very different Blue Ink, which had specialized in hedge fund investments.

Run us through some of your daily responsibilities and tasks.

Currently my main task is the development of the Blue Ink bespoke risk system. We have developed systems to monitor and report on aspects as diverse as from early detection of underperformance to breaches of investment mandates. I am currently integrating and automating these systems so that users can spend more time proactively analyzing the data, as opposed to generating the data and merely being reactive.

What are the challenges you face in this industry?

A huge challenge to the hedge fund industry is transparency, or, to put it more bluntly,

a general lack of transparency. This is an often lamented thorn in the side of the industry. Without wanting to oversimplify, it's clear that fund managers need to keep what they are doing a secret, lest everyone copy their strategies and, in so doing, nullify their efforts and, concomitantly, the clients' returns. However, the same veil of secrecy has seen too many people have their investments eroded (and not just by unscrupulous operators). Mitigation of the risks posed by lack of transparency, quite simply, requires transparency. Consider, if you will, for a moment how difficult it becomes to verify information from funds that we are considering investing in, even. Fortunately, in South Africa specifically, the tide seems to be turning from a stance of "trust us or you miss our boat [all too often spelt 'gravy train']" to a more pragmatic invitational stance of "come look under the hood - what you see is what you get". Indeed Blue Ink has been and shall continue to be actively involved in the move towards regulation of the industry.

What do you enjoy most about your job?

I derive a huge amount of satisfaction from using technologies to automate processes. In my mind's eye, there's nothing I would prefer to do more than be idle all day, but not when there's so much work to be done. It's quite ironic when I consider the lengths I am prepared to go to and the colossal amount of work I am prepared to do in order to attain this satisfaction. Fortunately, there are also the team mates and the coffee.

Tell us about your working environment.

Blue Ink's working environment is very pleasant and supportive. It's fantastic to be in a space full of people who are smart and willing to impart their knowledge and experience with infectious enthusiasm.

Tell us about your past experience and jobs.

Whereas I read politics and law at UCT, I followed a circuitous route to becoming a programmer by producing full text legal databases and developing Windows-based software for researching and retrieving related data. I had the great fortune of being guided and trained by arguably one of the best developers in the country, if not the world. I put this knowledge to good use and have developed many diverse software and hardware systems. These even extend to devices instrumental in the early detection and management of AIDS in the workplace.

What do you like about the IT line of work?

Actually, programming is much simpler than people make it out to be. Frustratingly, computers do exactly what we tell them to do and not what we intended them to do. Coming to terms with these frustrations then, in a nutshell, is what separates programmers from non-programmers.

What is your philosophy?

Do the right things and do those things right.

What are your key life learnings?

There are opportunities everywhere, but only for those who are looking for them. If you just try, inevitably you will succeed, as long as you don't give up.

What is your greatest achievement?

A friend, who was born blind, became a lawyer and utilized computers and devices to "read" the content of the screen. However, every time he scrolled down a line, the entire screen would be "re-read" to him and he would have to listen to it all again, except for the last line. I reprogrammed his computer screen, to enable it to only "read" the last line and effectively revolutionized his world. Knowing that I made such a difference to his experience of life motivates me every day to strive to do the same for others.

How do you spend your time on weekends?

Playing "Guitar Hero" with my two girls in their virtual band is fantastic. I'm the designated drummer and I'm not really encouraged to sing, but any other activity with them is also fantastic. I also enjoy driving my car, on a scenic mountain road and if reincarnation actually happens, I hope I'm a rally driver in my next life.

What big decision are you currently wrestling with?

I'm wrestling with my apparent inability to give effect to my decision to quit smoking.

What are your extra mural interests/activities?

I am passionate about woodwork and specifically making intricate clocks. To borrow a clause from Dr Seuss: "There's something about all those Ticks and Tocks that fill my Box...". ■

NOTICE BOARD

FICA DOCUMENTATION

We would like to thank all those clients who have submitted their updated FICA documents.

This is just a friendly reminder to please send these documents to us in the prepaid envelope provided. This is to ensure that we have the correct information on file.

GOT A QUESTION?

Our doors are always open and we welcome any questions you may have - investment or administration-related.

Please contact Donné Venter on (021) 673 3322 or email her at clientservices@blueink.co.za