A **private equity fund** to cheer retail investors

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A challenge for growth-orientated retail investors in South Africa is the lack of opportunities in the local market, with traditional asset classes looking quite expensive at the moment. Local equities are expensive relative to other emerging market equities and to the JSE's own long-term history. Listed property also looks expensive from a yield perspective and the next move in interest rates is more likely to be up than down. This really leaves growth investors with just two opportunity sets: offshore or alternative.

In the alternative space, investors can consider hedge funds and private equity options. As a business, we are not yet convinced of the merits of hedge funds as an asset class. They remain expensive and they have not lived up to their value proposition of protecting capital in volatile markets on a consistent enough basis. There is also the possibility of an event wiping out an entire fund, as was the case with Everest Capital's Global Fund following the unexpected scrapping of the Swiss franc's cap against the euro in January. We have, however, been incorporating private equity into client portfolio for the past few years via Old Mutual Private Equity (OMPE).

OMPE is one of the largest private equity managers in SA, managing over R10bn of private equity assets on behalf of Old Mutual Life Assurance Company and third-party investors.

The Old Mutual Private Equity Multi Manager Fund 3 is the only private equity fund available to retail investors in SA at the moment. The main attraction of private equity in a growth portfolio is the low correlation

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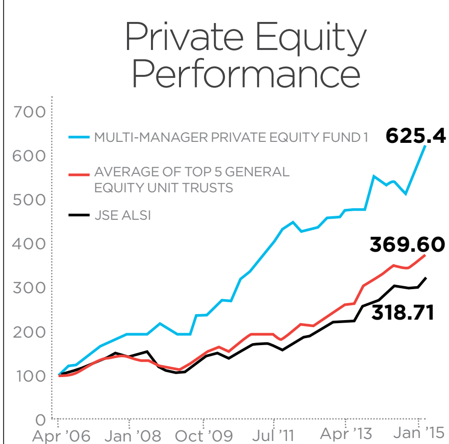
of returns to other growth asset classes, which is an important factor from a portfolio risk mitigation perspective.

The Multi Manager Fund is invested in funds managed by established private equity players such as Old Mutual Private Equity, Actis, Ethos, Capitalworks, and Carlyle (in its Sub-Saharan Africa Fund). Some of the companies that the fund is invested in already include Consol Glass, Actom, Reclamation and Tracker.

This is a high-risk fund that aims to aggressively outperform inflation. Private equity funds have the potential to outperform traditional asset classes over the long term and to provide diversification for the sophisticated investor through their low correlation with other asset classes. The key to this private equity fund is the partially invested nature of the underlying funds and the quality of the underlying investee companies in these funds.



SOURCE: Old Mutual

TAX AND LIQUIDITY

The investment is housed in a life-wrapped structure (endowment), meaning that all taxes are incurred within the fund and paid by the life company. Tax is charged at a lower rate (30%) than if it was incurred by a client earning more than R701 300 per annum. However, the client has to give up access to these funds for at least a five-year period. The lack of liquidity is one of the reasons we recommend a client invest up to a maximum of 10% of their investment portfolio in such an investment.

The Multi Manager Fund 3 portfolio would be closing to retail investors in June. The fund is nearing the end of the R600m tranche made available to retail investors, but have also chosen to put a firm date to the capping of the portfolio.

The graph illustrates the potential private equity holds. Launched in May 2006, Multi-Manager Private Equity Fund 1 is Old Mutual's first private equity fund of funds and is close to maturing. The fund has delivered an internal rate of return (IRR) of 27.1% per annum since inception, showing strong outperformance of both inflation and listed equity. (The Multi Manager Fund 3 only has a track record of 21 months; Fund 1 is therefore chosen for a more comprehensive comparison.) ■

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