Morningstar's Perspectives on Liquid Alternatives & New Equity Strategies

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How Morningstar Defines “Alternatives”

- An investment can be defined as “alternative” if it falls into one or more of the following three buckets:
  - Non-traditional asset classes (i.e. commodities and currencies).
  - Non-traditional strategies (i.e. shorting or hedging).
  - Illiquid assets (i.e. private equity, private debt).

- A good alternative investment is one that produces positive risk-adjusted returns (over a reasonable time frame) and exhibits a lower correlation to traditional investments.

- Dynamic classification: once mainstream, no longer “alternative”.

- Legal structure does not define the investment.
How Can One Access Alternatives?

► Private partnerships/offshore corporations (Hedge Funds)
  ► Accredited investor status, high minimum investments, performance fee, no required transparency.
  ► The most options.

► Mutual Funds
  ► Daily redemptions, no performance fee, SEC registered, quarterly holdings.
  ► Ample options, most new.

► Exchange Traded Funds
  ► Intraday trading, daily holdings, low cost.
  ► Fewer options.
Liquid Alternative ETF and Mutual Fund Assets USD Bil

- Mutual Funds
- ETFs

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Flows into Liquid Alternatives: Mutual Funds USD Bil

- Bear Market
- Currency
- Long/Short Equity
- Market Neutral
- Managed Futures
- Multialternative
- Nontraditional Bond
- Managed Futures

Classification Chart

Mutual Fund and ETF Categories

- Multialternative
  - Equity-based Categories
    - Bear Market
    - Long/Short Equity
    - Market Neutral
  - Nontraditional Bond Categories
  - Commodities Categories
  - Multi-Currency
  - Derivatives Categories
    - Managed Futures
    - Volatility
    - Trading Inverse/Leveraged
Evolution of Fund Ratings

Past
- Morningstar Category Ranking: #1 in Category

Risk
- Morningstar Rating: ★★★★★

Future
- Morningstar Analyst Rating:
  - Gold
  - Silver
  - Bronze
  - Neutral
  - Negative
The Five Pillars

People  Process  Parent  Performance  Price
How Much to Allocate to Alternatives?

Institutions and Advisors: Allocation to Alternative Investments in 2011

Respondents %

- Institutions
- Advisors
How to Allocate to Alternative Investments?

- **Options:**
  - Multi-Alternative one-stop shop—how big a “bucket”
  - Pick a few strategies yourself—how to weight?

- **Where to allocate from—out of the riskiest part of the portfolio:**
  - Historically, most of a traditional portfolio’s risk comes from equities.
  - More risk will be coming from bonds in the future.

- **Based on risk/return profiles:**
  - Long-short equity and managed futures strategies historically show higher levels of returns and volatility.
  - Market neutral, currency, and non-traditional bond funds should exhibit lower risk and return levels, similar to bonds.
Equity-Heavy Traditional Portfolios

Risk in a 60/40 Portfolio
10.1% Standard Deviation

Risk in a 27/73 Portfolio
6.5% Standard Deviation

Risk in a 50/50 Portfolio
8.8% Standard Deviation

- Risk from Stocks
- Risk from Bonds
How to Weight Alts Strategies?

Equal Weighted Alts Portfolio

- S&P 500
- Barclays US Agg Bond
- Managed Futures
- Market Neutral
- Long Short Equity
New Equity + Allocation Strategies

- Intended to lower equity risk—volatility or drawdowns

- Low volatility equity
  - Main focus on less volatile stocks, not necessarily drawdowns
  - Passive, quasi-passive, active
  - Result of stock-specific characteristics—quality, dividend streams, etc.

- Risk parity
  - Primary emphasis on volatility, not drawdowns
  - Use leverage to amplify exposure to lower-volatility areas

- Risk factor—single or multi-asset class
  - Risk factor exposure: equity, rates, commodities, FX, momentum
  - May include tail-risk hedging—protection against drawdowns
  - Allocation funds: top-down view necessary to guide allocation/hedging
Evidence That Lower Volatility Strategies are Easier To Use

Asset-weighted investor shortfall for all open-ended funds

<table>
<thead>
<tr>
<th>Category</th>
<th>Shortfall</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Equity</td>
<td>1.01</td>
</tr>
<tr>
<td>International</td>
<td>3.11</td>
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<tr>
<td>Taxable Bond</td>
<td>0.87</td>
</tr>
<tr>
<td>Municipal Bond</td>
<td>1.35</td>
</tr>
<tr>
<td>Balanced</td>
<td>0.84</td>
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</tbody>
</table>

10-Year Period through 12/31/2012
## Evidence That Lower Volatility Strategies are Easier To Use

Asset-weighted investor shortfalls for most, least volatile quartiles

### Large Value

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Most</td>
<td>1.91</td>
</tr>
<tr>
<td>Least</td>
<td>1.49</td>
</tr>
</tbody>
</table>

### Foreign Large Blend

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Most</td>
<td>2.13</td>
</tr>
<tr>
<td>Least</td>
<td>0.68</td>
</tr>
</tbody>
</table>

### World Stock

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Most</td>
<td>1.41</td>
</tr>
<tr>
<td>Least</td>
<td>0.25</td>
</tr>
</tbody>
</table>

10-Year Period through 7/31/13
But…..First Get Clear On The Why and Where

► First question—why are you considering them?
  ► Potential for more attractive risk/reward profile
  ► Tail-risk protection—lower volatility may not get you there
  ► Keeping investors in their seats

► Second question—where do you want them to fit in an investor’s portfolio?
  ► Core holding—replace equity exposure or core allocation fund
  ► Complement existing exposure

► Third question—do you truly need a new vehicle to accomplish your goal?
  ► Address with asset allocation or portfolio construction?
  ► Other vehicles useful? (e.g. cash, bond fund, proven actively-managed equity fund, alternatives)
Be Skeptical Of The Pitch

- Basic tenets of risk/reward and diversification have not vanished
  - Lower risk = lower reward
  - Lower risk/reward + leverage = higher risk
  - Goal of diversification is to get it approximately right, not exactly wrong

- Claims of lower risk often introduce unintended sources of risk
  - Volatility does not capture all risks—it can mask them
  - Price matters
  - Leverage requires a higher risk appetite, not lower
    - Magnifies on the up and downsides
    - On the downside—additional risks of liquidity and forced selling

- Don’t mistake specificity for certainty!
The Story Does Not Outweigh Fundamentals

- People: beware short track records, areas of thin expertise
- Process: what is management’s goal, what can you reasonably expect?
- Parent: what proof is there that the Parent can support the strategy?
- Performance: beware short track records, time-period bias, fighting the last war
- Price: higher fees in reality will erode the potential advantages
## Notable Strategies To Consider

<table>
<thead>
<tr>
<th>Name</th>
<th>Ticker</th>
<th>M* Category</th>
<th>AUM ($ Mil)</th>
<th>Expense Ratio</th>
<th>M* Rating</th>
<th>M* Analyst Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RISK PARITY</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>AQR Risk Parity N</td>
<td>AQRNX</td>
<td>OE World Allocation</td>
<td>1,133.0</td>
<td>1.20</td>
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<tr>
<td>Invesco Balanced-Risk Alloc A</td>
<td>ABRZX</td>
<td>OE World Allocation</td>
<td>12,863.0</td>
<td>1.10</td>
<td>3</td>
<td>Neutral</td>
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<tr>
<td><strong>RISK FACTOR</strong></td>
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<td></td>
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<td></td>
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<tr>
<td>AQR International Momentum L</td>
<td>AIMOX</td>
<td>OE Foreign Large Growth</td>
<td>227.7</td>
<td>0.65</td>
<td>3</td>
<td>Bronze</td>
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<tr>
<td>AQR Momentum L</td>
<td>AMOMX</td>
<td>OE Large Growth</td>
<td>738.8</td>
<td>0.49</td>
<td>4</td>
<td>Bronze</td>
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<tr>
<td>AQR Small Cap Momentum L</td>
<td>ASMOX</td>
<td>OE Small Growth</td>
<td>218.4</td>
<td>0.65</td>
<td>4</td>
<td>Bronze</td>
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<tr>
<td>PIMCO Global Multi-Asset Instl</td>
<td>PGAIX</td>
<td>OE World Allocation</td>
<td>3,813.8</td>
<td>0.52</td>
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<td>Bronze</td>
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<tr>
<td><strong>PASSIVE/QUASI-PASSIVE LOW VOLATILITY</strong></td>
<td></td>
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<td>iShares MSCI USA Minimum Volatility</td>
<td>USMV</td>
<td>ETF Large Value</td>
<td>2,263.5</td>
<td>0.15</td>
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<td>iShares MSCI EAFE Minimum Volatility</td>
<td>EFAV</td>
<td>ETF Foreign Large Value</td>
<td>777.7</td>
<td>0.20</td>
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<tr>
<td>iShares MSCI Emerging Markets Mini Vol</td>
<td>EEMV</td>
<td>ETF Diversified Emerging Mkts</td>
<td>2,519.5</td>
<td>0.25</td>
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<tr>
<td>AQR US Defensive Equity N</td>
<td>AUENX</td>
<td>OE Large Blend</td>
<td>132.7</td>
<td>1.00</td>
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<tr>
<td>AQR International Defensive Equity N</td>
<td>ANDNX</td>
<td>OE Foreign Large Blend</td>
<td>16.6</td>
<td>1.15</td>
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<tr>
<td>AQR Emerging Defensive Equity N</td>
<td>AZENX</td>
<td>OE Diversified Emerging Mkts</td>
<td>20.9</td>
<td>1.40</td>
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</tbody>
</table>
## Notable Strategies To Consider

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<tr>
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<th>M* Rating</th>
<th>M* Analyst Rating</th>
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<tr>
<td><strong>ACTIVE “LOW VOLATILITY”</strong></td>
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<td>American Century Equity Income Inv</td>
<td>TWEIX</td>
<td>OE Large Value</td>
<td>10,434.9</td>
<td>0.93</td>
<td>5</td>
<td>Silver</td>
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<tr>
<td>JPMorgan Equity Income Select</td>
<td>HLIEX</td>
<td>OE Large Value</td>
<td>4,965.2</td>
<td>0.78</td>
<td>5</td>
<td>Bronze</td>
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<tr>
<td>Vanguard Equity Income Inv</td>
<td>VEIPX</td>
<td>OE Large Value</td>
<td>13,803.0</td>
<td>0.30</td>
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<td>Silver</td>
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<td>Amana Income</td>
<td>AMANX</td>
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<td>1,453.7</td>
<td>1.18</td>
<td>4</td>
<td>Silver</td>
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<td>BBH Core Select N</td>
<td>BBTEX</td>
<td>OE Large Blend</td>
<td>5,698.2</td>
<td>1.00</td>
<td>5</td>
<td>Silver</td>
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<td>Sequoia</td>
<td>SEQUX</td>
<td>OE Large Blend</td>
<td>7,119.4</td>
<td>1.00</td>
<td>5</td>
<td>Gold</td>
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<tr>
<td>Morgan Stanley Inst International Eq I</td>
<td>MSIQX</td>
<td>OE Foreign Large Blend</td>
<td>5,169.1</td>
<td>0.95</td>
<td>5</td>
<td>Silver</td>
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<td>Artisan International Value Investor</td>
<td>ARTKX</td>
<td>OE Foreign Large Blend</td>
<td>9,107.1</td>
<td>1.17</td>
<td>5</td>
<td>Gold</td>
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<td>Thornburg International Value A</td>
<td>TGVAX</td>
<td>OE Foreign Large Growth</td>
<td>28,278.2</td>
<td>1.29</td>
<td>3</td>
<td>Silver</td>
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<td>Harding Loewner Global Equity Advisor</td>
<td>HLMGX</td>
<td>OE World Stock</td>
<td>566.3</td>
<td>1.23</td>
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<td>Silver</td>
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<td>MFS Global Equity A</td>
<td>MWEFX</td>
<td>OE World Stock</td>
<td>1,496.7</td>
<td>1.34</td>
<td>4</td>
<td>Gold</td>
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<tr>
<td>Virtus Global Opportunities A</td>
<td>NWWOX</td>
<td>OE World Stock</td>
<td>110.1</td>
<td>1.55</td>
<td>3</td>
<td>Bronze</td>
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</tbody>
</table>
Questions & Comments

- Josh.Charney@morningstar.com 312-244-7540
- Michael.Herbst@morningstar.com 312-384-3902

Websites:

- http://www.morningstar.com/Cover/Funds.aspx
Appendix
History of Alternatives

1946
First Private Equity Funds

1949
First Hedge Fund

1966
Fortune Magazine article popularizing Hedge Funds

1980’s
Rise of Global Macro Hedge Funds

1990’s
The Yale “Endowment Model” catches on

1997
Repeal of “short-short” rule

2008
Financial Crisis and rise of Liquid Alternatives
Why Invest in Alternatives?

- Modern Portfolio Theory:
  - Positive Sharpe ratio (or other risk-adjusted return measure) + lower correlation = improved portfolio risk-adjusted return.
  - Portfolio variance: \( \sigma_p^2 = \sum w_i^2 \sigma_i^2 + \sum \sum w_i w_j \sigma_i \sigma_j \rho_{ij} \).

- Avoiding/reducing downturns can improve long-term wealth.
## Traditional Asset Class Correlations Rise During Crisis Times

<table>
<thead>
<tr>
<th>52-Week Correlation to S&amp;P 500 TR</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russell 2000 TR USD</td>
<td>0.92</td>
<td>0.94</td>
<td>0.96</td>
<td>0.93</td>
<td>0.97</td>
<td>0.88</td>
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<tr>
<td>MSCI EAFE GR USD</td>
<td>0.78</td>
<td>0.86</td>
<td>0.80</td>
<td>0.85</td>
<td>0.87</td>
<td>0.85</td>
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<tr>
<td>MSCI EM GR USD</td>
<td>0.67</td>
<td>0.79</td>
<td>0.83</td>
<td>0.83</td>
<td>0.75</td>
<td>0.67</td>
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<tr>
<td>BarCap US Corp IG TR USD</td>
<td>-0.34</td>
<td>0.12</td>
<td>0.10</td>
<td>-0.16</td>
<td>-0.37</td>
<td>-0.47</td>
</tr>
<tr>
<td>BarCap US Corporate High Yield TR USD</td>
<td>0.66</td>
<td>0.73</td>
<td>0.51</td>
<td>0.66</td>
<td>0.55</td>
<td>0.57</td>
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<tr>
<td>BarCap Municipal TR USD</td>
<td>-0.18</td>
<td>-0.01</td>
<td>-0.13</td>
<td>-0.14</td>
<td>-0.46</td>
<td>-0.37</td>
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<tr>
<td>JPM EMBI Global TR USD</td>
<td>0.53</td>
<td>0.72</td>
<td>0.63</td>
<td>0.54</td>
<td>0.38</td>
<td>0.38</td>
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<tr>
<td>BarCap Global Treasury Ex US TR USD</td>
<td>-0.44</td>
<td>-0.16</td>
<td>0.08</td>
<td>0.08</td>
<td>0.21</td>
<td>0.04</td>
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<tr>
<td>BarCap US Treasury TR USD</td>
<td>-0.53</td>
<td>-0.37</td>
<td>-0.39</td>
<td>-0.50</td>
<td>-0.74</td>
<td>-0.71</td>
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</table>
Performance of Managed Futures During Crisis: 6/2007-12/2008

<table>
<thead>
<tr>
<th>Investment Name</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P Diversified Trends Indices</td>
<td>11.57K</td>
</tr>
<tr>
<td>S&amp;P 500 TR (Market Return)</td>
<td>6.21K</td>
</tr>
<tr>
<td>DJ UBS Commodity TR USD</td>
<td>7.19K</td>
</tr>
<tr>
<td>ICE USD Futures (Market Ret..)</td>
<td>10.06K</td>
</tr>
</tbody>
</table>
Long-Short Equity Returns Relative to the S&P 500
Merger Arbitrage Returns Relative to Interest Rates: 1998-2012

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Managed Futures Returns Relative to Interest Rates
Growth of Hedge Fund Assets

Assets in Morningstar’s Hedge Fund Database USD Bil

- Single Manager Hedge Funds
- Funds of Hedge Funds
Classification of Alternative Investments

- By asset and directionality/trading strategy.
  - Equity, debt, or derivatives.
    - Can be further classified by geography.
  - Net long (directional), net short (directional) or neutral (non directional) exposure.
    - Gross long (all long positions) – gross short (all short positions) = net long or short.

- More classifications for hedge funds than for mutual funds or ETFs.
- Classifications are similar across legal structure and geography.
Category: Long-Short Equity

- This is the largest categories in terms of assets ($36 billion, 88 funds as of 5/28).
- These funds take a hedged, net-long exposure to the stock market.
- Typical beta ranges between 0.3 and 0.8, averages 0.5.
- Several variations on the strategy:
  - Long and short directional bets on individual stocks or indexes
    - Wasatch Long/Short FMLSX, Accuvest Global Long Short AGLS
  - Long stock + short calls + long puts.
    - Gateway GATEX, Schooner SCNAX
Category: Market Neutral

▪ These funds hedge out most equity market risk, and exhibit betas to stock indexes of between -0.3 to 0.3.
▪ Risk/return levels are similar to bond funds.
▪ Three major strategies: equity market neutral, merger arbitrage, and convertible arbitrage.
▪ Equity Market Neutral:
  ▪ These funds take long and short positions in stocks such that the market risk in the long positions is virtually offset by the short positions.
  ▪ The goal is to isolate “alpha” from stock selection.
  ▪ JPMorgan Research Market Neutral JMNAX, Proshares RAFI Long/Short RALS.
Category: Market Neutral (continued)

- Merger Arbitrage:
  - These funds buy target stocks and short the acquirer (stock-for-stock transaction) or short calls (cash transaction).
  - The goal is to isolate the premium paid for the target.
  - Collecting premium is selling insurance on the deal closing.
  - Merger Fund MERFX, Credit Suisse Merger Arbitrage CSMA.

-Convertible Arbitrage:
  - These funds buy convertible bonds and short the stocks of the same issuer.
  - The goal is to benefit from the mispricing of the convertible bond, which includes an embedded option.
  - Convertible bond holders are paid an illiquidity premium.
  - Calamos Market Neutral Income CMNIX.
Category: Bear Market

- These funds take a net short exposure to stocks.
- Most funds in the category are inverse and levered-inverse index funds.
- These funds, like other “tail-hedges,” are not good long term investments.
Category: Nontraditional Bond

- These funds invest primarily in debt (all types) but hedge duration risk, credit risk, or both.
- “Unconstrained bond” or “strategic income” funds, which take long bets on primarily high yield bonds, but can reduce or short duration (typically through Treasury futures or swaps) if necessary.
  - PIMCO Unconstrained Bond PUBAX, JP Morgan Strategic Income Opportunities JSOAX
- Other funds trade sovereign developed or emerging market credit, interest rates, or currencies, while some focus on domestic corporates or munis.
  - Eaton Vance Global Macro Absolute Return EAGMX
  - Dreihaus Active Income Fund LCMAX
  - Forward Credit Analysis Long/Short FLSFX.
Category: Managed Futures

- These funds take long and short bets on futures contracts based upon positive or negative price momentum, typically across various asset classes.
- Systematic, automated strategies, which can range in volatility.
- Single-manager versus multi-CTA structures:
  - Single manager structures can be less diversified in terms of strategy, but are much cheaper.
    - AQR Managed Futures AQMIX, WisdomTree Managed Futures WDTI.
  - Multi-CTA structures charge underlying management and performance fees which are not included in the expense ratio:
    - Mutualhedge Frontier Legends MHFAX, Altegris Managed Futures MFTAX.
Category: Multi-Currency

- These funds invest in short-term (non U.S.) government debt or currency futures or forwards.

- Most take a short USD exposure:
  - Franklin Templeton Hard Currency, Powershares DB US Dollar Index Bearish UDN.

- Other strategies include momentum or carry (long high-yield, short low-yield) strategies.
  - PowerShares DB G10 Currency Harvest DBV, Merk Absolute Currency MABFX.

- Most mutual funds are actively managed and diversified, while most ETFs are single currency indexes.

- Risk/return profile similar to bond funds.
Category: Multialternative

- This is the second largest category: 92 funds and $27 billion (as of May 28, 2013).
- These funds offer a diversified mix of alternative strategies and asset classes, accessed through separate accounts, ETFs, or mutual funds.
- Most, but not all, multialternative funds are also multimanager:
  - Absolute Strategies ASFIX, Hatteras Alpha Hedged Strategies ALPHX.
- Some are managed in-house, though:
  - AQR Multi-Strategy Alternative ASAIX.
- There are a growing number of tactical funds in this category.
  - JHancock2 Global Absolute Return JHAAX, UBS Dynamic Alpha BNAAX.
Morningstar Analyst Ratings for Alternative Mutual Funds

- Debuted in June 2012.
  - 45 funds, 75% of assets.
  - 80 funds and 85% of assets by Q2 2013.
  - Global Fund Reports for all 80 funds.

- Same 5 Pillars: people, parent, process, performance, price.

- Same rating system: positive (gold, silver, bronze); neutral; negative.

- Unique application for alternative mutual funds.
### Morningstar Analyst Ratings: 5 Pillars

<table>
<thead>
<tr>
<th>People</th>
<th>Hedge fund track records.</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Experience with shorting and risk management.</td>
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<tr>
<td></td>
<td>Key-man risk.</td>
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<tr>
<td></td>
<td>Reasonable investment in mutual fund.</td>
</tr>
<tr>
<td>Parent</td>
<td>Boutique shops.</td>
</tr>
<tr>
<td></td>
<td>Series trusts: some boards spread too thin with little or no investment in funds.</td>
</tr>
<tr>
<td></td>
<td>Close eye on product launches and capacity constraints.</td>
</tr>
</tbody>
</table>
**People: Merger MERFX Snapshot**

### Experience and Asset Load

<table>
<thead>
<tr>
<th>Total AUM Bill USD in Funds Managed</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image_url" alt="Graph" /></td>
</tr>
</tbody>
</table>

### Management Team

<table>
<thead>
<tr>
<th>Number of Managers</th>
<th>Longest Tenure</th>
<th>5-Year Manager-Retention Rate (Firm-wide)</th>
<th>Largest Manager Investment in Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>6.25 Years</td>
<td>93%</td>
<td>More than 1 Mil USD</td>
</tr>
</tbody>
</table>

**Advisor**
Westchester Capital Management LLC

**Subadvisor**
—

---

**Roy D. Behren** 01/07 to Present

<table>
<thead>
<tr>
<th>Years of Experience</th>
<th>Investment in Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>19</td>
<td>More than 1 Mil USD</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fund AUM</th>
<th>Current Funds Managed</th>
</tr>
</thead>
<tbody>
<tr>
<td>4,662 Mil USD</td>
<td>3</td>
</tr>
</tbody>
</table>

**Largest Funds Managed**

<table>
<thead>
<tr>
<th>Tenure Dates</th>
<th>Role</th>
<th>Fund Size Bil USD</th>
<th>Investment Mil USD</th>
<th>Turnover Ratio Avg</th>
<th>Tenure Ret %</th>
<th>Index Ret %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merger Fund</td>
<td>01/07-Present</td>
<td>1 of 2</td>
<td>4.45</td>
<td>&gt;1</td>
<td>247</td>
<td>2.73</td>
</tr>
<tr>
<td>Dunham Monthly Distribution Fd</td>
<td>09/08-Present</td>
<td>Load</td>
<td>0.21</td>
<td>&lt;1</td>
<td>299</td>
<td>4.51</td>
</tr>
<tr>
<td>Merger Fund VL</td>
<td>01/07-Present</td>
<td>1 of 2</td>
<td>0.02</td>
<td>—</td>
<td>377</td>
<td>4.05</td>
</tr>
</tbody>
</table>

---

**Michael T. Shannon** 01/07 to Present

<table>
<thead>
<tr>
<th>Years of Experience</th>
<th>Investment in Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>17</td>
<td>More than 1 Mil USD</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fund AUM</th>
<th>Current Funds Managed</th>
</tr>
</thead>
<tbody>
<tr>
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**Largest Funds Managed**

<table>
<thead>
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</thead>
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</tr>
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<td>Dunham Monthly Distribution Fd</td>
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<td>1 of 2</td>
<td>0.21</td>
<td>&lt;1</td>
<td>299</td>
<td>4.51</td>
</tr>
</tbody>
</table>
Parent: TFS Market Neutral TFSMX Snapshot
# Morningstar Analyst Ratings: 5 Pillars

<table>
<thead>
<tr>
<th>Process</th>
<th>Transparent and repeatable.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Shorting process must differ from long process: timing, position limits, etc.</td>
</tr>
<tr>
<td></td>
<td>Risk-management process is essential: top-down exposure limits; bottom-up position loss limits; steps to increase and reduce risk, etc.</td>
</tr>
<tr>
<td></td>
<td>Trading/transaction cost considerations.</td>
</tr>
</tbody>
</table>
Morningstar Analyst Ratings: 5 Pillars

<table>
<thead>
<tr>
<th>Performance</th>
<th>Short mutual fund track records.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Different risk/return profiles in different market environments.</td>
</tr>
<tr>
<td></td>
<td>Heterogeneous categories.</td>
</tr>
<tr>
<td></td>
<td>Lack of industry standard benchmarks.</td>
</tr>
<tr>
<td></td>
<td>Statistics such as alpha, beta, correlation, bear correlation, upside/downside capture, maximum drawdown.</td>
</tr>
</tbody>
</table>
Performance: JP Morgan Strategic Income JSOAX Snapshot

<table>
<thead>
<tr>
<th>Relative Performance 11/1/2008 to 3/31/2013</th>
<th>B-mark 1</th>
<th>B-mark 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess Return</td>
<td>-11.93</td>
<td>-0.22</td>
</tr>
<tr>
<td>Alpha</td>
<td>-0.55</td>
<td>3.64</td>
</tr>
<tr>
<td>Beta</td>
<td>0.44</td>
<td>0.51</td>
</tr>
<tr>
<td>R-Squared</td>
<td>73.44</td>
<td>7.95</td>
</tr>
<tr>
<td>Tracking Error</td>
<td>6.85</td>
<td>5.59</td>
</tr>
<tr>
<td>Information Ratio</td>
<td>-1.74</td>
<td>-0.04</td>
</tr>
<tr>
<td>Treynor Ratio</td>
<td>17.63</td>
<td>14.99</td>
</tr>
<tr>
<td>Up Capture Ratio</td>
<td>41.61</td>
<td>83.53</td>
</tr>
<tr>
<td>Down Capture Ratio</td>
<td>42.75</td>
<td>-1.52</td>
</tr>
<tr>
<td>Up Number Ratio</td>
<td>0.86</td>
<td>0.77</td>
</tr>
<tr>
<td>Down Number Ratio</td>
<td>0.90</td>
<td>0.56</td>
</tr>
<tr>
<td>Up Percentage Ratio</td>
<td>0.00</td>
<td>0.52</td>
</tr>
<tr>
<td>Down Percentage Ratio</td>
<td>1.00</td>
<td>0.56</td>
</tr>
</tbody>
</table>

Benchmark 1: BofAML US HY Master II
Benchmark 2: Barclays US Universal
### Morningstar Analyst Ratings: 5 Pillars

<table>
<thead>
<tr>
<th>Price</th>
<th>More expensive than stock and bond funds.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Use net expense ratio.</td>
</tr>
<tr>
<td></td>
<td>Relative to category and distribution channel.</td>
</tr>
<tr>
<td></td>
<td>Managed futures funds charge fees not included in the expense ratios.</td>
</tr>
</tbody>
</table>
Price: Gateway GATEX Snapshot

Expense Breakdown

<table>
<thead>
<tr>
<th>Component</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Expense Ratio</td>
<td>0.94</td>
</tr>
<tr>
<td>Annual Report 12/31-12</td>
<td>0.94</td>
</tr>
<tr>
<td>Prospectus 04/01-13</td>
<td>0.94</td>
</tr>
<tr>
<td>Management Actual</td>
<td>0.65</td>
</tr>
<tr>
<td>12b-1 Fee</td>
<td>0.25</td>
</tr>
<tr>
<td>Brokerage Commission (% of Avg Net Assets)</td>
<td>0.06</td>
</tr>
<tr>
<td>Category Average</td>
<td>0.64</td>
</tr>
<tr>
<td>Tax Cost Ratio (3-Year)</td>
<td>0.47</td>
</tr>
<tr>
<td>Potential Capital Gains Exposure</td>
<td>9</td>
</tr>
</tbody>
</table>

Fee Level

<table>
<thead>
<tr>
<th>Fee Level</th>
<th>Peer Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Alternative Front Load</td>
</tr>
</tbody>
</table>

Fee Level Breakpoints

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>&gt;2.39</td>
</tr>
<tr>
<td>Above Average</td>
<td>1.88-2.39</td>
</tr>
<tr>
<td>Average</td>
<td>1.65-1.88</td>
</tr>
<tr>
<td>Below Average</td>
<td>1.41-1.65</td>
</tr>
<tr>
<td>Low</td>
<td>&lt;1.41</td>
</tr>
</tbody>
</table>

- Fund: 0.94
- Peer Median: 1.75
## Average Annual Report Net Expense Ratios

<table>
<thead>
<tr>
<th>Alternative Mutual Fund Categories</th>
<th>Average Annual Report Net Expense Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bear Market</td>
<td>1.93</td>
</tr>
<tr>
<td>Currency</td>
<td>1.33</td>
</tr>
<tr>
<td>Long/Short Equity</td>
<td>1.94</td>
</tr>
<tr>
<td>Managed Futures*</td>
<td>2.61</td>
</tr>
<tr>
<td>Market Neutral</td>
<td>1.67</td>
</tr>
<tr>
<td>Multialternative**</td>
<td>2.06</td>
</tr>
<tr>
<td>Nontraditional Bond</td>
<td>1.31</td>
</tr>
</tbody>
</table>

*Does not include underlying management and performance fees of most funds.

**Prospectus Net Expense Ratio, which includes acquired fund fees
Volatility of Stocks and Bonds 1976-2012

Annualized Daily Std. Dev.

- S&P 500 TR
- Barclays US Agg Bond TR USD
# DIY Portfolio: What Strategies to Combine?

<table>
<thead>
<tr>
<th>Hedge Fund Index Correlations 2003-2012 (monthly)</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 TR</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Barclays US Agg Bond TR USD</td>
<td></td>
<td>0.04</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Morningstar MSCI North America (Long-Short Equity)</td>
<td></td>
<td>0.84</td>
<td>-0.03</td>
<td></td>
</tr>
<tr>
<td>Morningstar MSCI Systematic Trading (Managed Futures)</td>
<td>0.05</td>
<td>0.10</td>
<td>0.18</td>
<td></td>
</tr>
<tr>
<td>Morningstar MSCI Relative Value N Am (Market Neutral)</td>
<td>0.59</td>
<td>0.16</td>
<td>0.79</td>
<td>-0.03</td>
</tr>
</tbody>
</table>
Effect of Adding Alternatives to a Traditional Portfolio

<table>
<thead>
<tr>
<th>Annualized Returns and Risk-adjusted Returns</th>
<th>Return 3-Yr</th>
<th>Return 5-Yr</th>
<th>Return 10-yr</th>
<th>Sharpe Ratio 3-Yr</th>
<th>Sharpe Ratio 5-Yr</th>
<th>Sharpe Ratio 10-Yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>60-40 Stock/ Bond Portfolio*</td>
<td>9.46</td>
<td>4.02</td>
<td>6.74</td>
<td>1.07</td>
<td>0.36</td>
<td>0.58</td>
</tr>
<tr>
<td>10% Alts Portfolio**</td>
<td>8.76</td>
<td>4.25</td>
<td>6.58</td>
<td>1.14</td>
<td>0.42</td>
<td>0.63</td>
</tr>
<tr>
<td>20% Alts Portfolio**</td>
<td>8.03</td>
<td>4.44</td>
<td>6.40</td>
<td>1.24</td>
<td>0.50</td>
<td>0.70</td>
</tr>
</tbody>
</table>

*60% S&P 500 index, 40% Barclays US Aggregate Bond index

**Funded out of the 60% S&P 500 allocation, with equal weightings to the following three indexes: Morningstar MSCI North America Hedge Fund Index (to represent long-short equity); Morningstar MSCI Relative Value North America Hedge Fund Index (to represent equity market neutral); and Morningstar MSCI Systematic Trading Hedge Fund Index (to represent managed futures.)