



An Alternative to Rescue the Middle Class...Fund Family

Executive Summary

Liquid alternatives in mutual fund form have attracted a lot of attention in recent years and there has been growth in both products available and assets. The AUM has been concentrated however in a small number of funds and a very short list of product categories.

From the client perspective, returns have been low although Sharpe ratios are generally quite strong. Many of the very largest funds have a high correlation to the equity market however.

Successful alternative funds have often been from fund families with strong records of both marketing and investment success across their fund families.

Successful fund families come in all sizes. While there are some success stories amongst mid –sized fund families, more of these businesses could be leveraging their general success in investments and marketing to develop alternative products for investors.

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Introduction

The returns earned by investors in liquid alternatives have not been great in recent years, but investors and their advisers remain interested in this mutual fund category. As a result, fund families continue to have alternative products near the top of their new product development wish list.

Three years ago there were 947 alternative fund share classes tracked by Morningstar. Today, the number has nearly doubled to 1,664 share classes.

As is the case in most other product categories, winners are taking all. A small number of funds have over \$1 billion in AUM. Currently, there are 40 funds (with a total of 185 share classes tracked by Morningstar) with over \$1 Billion in assets under management.

Assets have been concentrated in just a few alternative product categories as well.

This report will examine the largest alternative funds and the most popular products.

The Popularity of Alternatives – How Is the Asset Class Doing? (Source: Morningstar)

Returns from alternative funds have not been the prime factor spurring interest in the category.

Annualized Investment Returns for Years Ending December 2015

Selected Morningstar Category Returns (Traditional)	One Year	Three Years	Five Years
US Equity – Large Blend	-1.1%	13.2%	10.8%
US Equity – Small Blend	-5.4	10.4	8.2
Foreign Large Blend Equity	-1.6	3.7	2.6
World Bond	-4.1	-1.6	1.3
Aggressive Allocation	-2.8	7.9	6.7
Retirement Income	-1.5	2.5	3.6
World Allocation	-6.2	2.1	3.5

Selected Morningstar Category Returns (Alternative)	One Year	Three Years	Five Years
Long Short Equity	-2.0%	5.4%	4.5%
Managed Futures	-1.0	2.6	-1.0
Market Neutral	-0.3	1.5	1.4
Multi-alternative	-2.6	1.7	2.1

But in spite of the so-so recent history of returns, there has been strong growth in AUM.

The Biggest Alternative Mutual Funds in the U.S. (over \$1 billion)
 (Source: Morningstar)

Fund Name	Morningstar Category
1. AQR Managed Futures Strategy	Managed Futures
2. John Hancock Global Absolute Return	Multi-alternative
3. Gateway	Long Short Equity
4. Boston Partners Long - Short	Long Short Equity
5. Diamond Hill Long - Short	Long Short Equity
6. Merger	Market Neutral
7. PIMCO Emerging Markets Currency	Multi-currency
8. Calamos Market Neutral Income	Market Neutral
9. Natixis ASG Global Alternative	Multi-alternative
10. AQR Multi Strategy Alternative	Multi-alternative
11. Natixis ASG Managed Futures	Managed Futures
12. Principal Global Strategy	Multi-alternative
13. AQR Style Premia Alternative	Multi-alternative
14. Catalyst Hedged Futures	Managed Futures
15. Neuberger Berman Long - Short	Long Short Equity
16. GMO SGM Major Markets	Multi-alternative
17. PIMCO RAE Worldwide Long - Short	Long Short Equity
18. Arbitrage	Market Neutral
19. Mainstay Marketfield	Long Short Equity
20. PIMCO StocksPlus Short	Bear Market
21. Gotham Absolute Return	Long Short Equity
22. William Blair Macro Allocation	Multi-alternative
23. Blackrock Global Long – Short Equity	Market Neutral
24. Swan Defined Risk	Long Short Equity
25. Goldman Sachs Multi Manager Alternative	Multi-alternative
26. Gabelli ABC	Market Neutral
27. Dreyfus Dynamic Total Return	Multi-alternative
28. Putnam Absolute Return	Multi-alternative
29. Litman Gregory Masters Alternative Strategy	Multi-alternative
30. AB US Select Long - Short	Long Short Equity
31. LoCorr Market Trend	Managed Futures
32. Equinox Campbell Strategy	Managed Futures
33. Vanguard Market Neutral	Market Neutral
34. Franklin K2 Alternative Strategy	Multi-alternative
35. Oppenheimer Fundamental Alternative	Multi-alternative
36. Putnam Absolute Return 500	Multi-alternative
37. GMO Special Opportunities	Multi-alternative
38. Neuberger Berman Absolute Return Multi Alternative	Multi-alternative
39. John Hancock Absolute Return Currency	Multi-currency
40. Goldman Sachs Absolute Return	Multi-alternative

The Most Popular Categories Amongst the \$1Billion+ Funds

You may have noted that the largest funds cluster in just a few alternatives sub – categories.

Category	Number of Funds Over \$1Billion in AUM
Multi – alternative	17
Long Short Equity	9
Market Neutral	6
Managed Futures	5
Multi - currency	2
Bear Market	1
Other	0

Summary of the Investment Strategies Used by the Funds Most in Demand

Just 3 sub - categories account for 3 out of 4 of the \$1B+ liquid alts funds: Multi Alts, Long/Short and Market Neutral.

Multi – Alts funds with over \$1 billion in AUM tend to use between 10 and 15 sub – advisors as managers. There are often several managers used for each of the alternative strategies. Usually fewer than 10 investment strategies are used.

Very few of these funds are quantitative. That may be because of the enormous amount of data that would be needed to manage a multi - alts fund.

The multi – alts funds tend to be more tactical than strategic in their investing. They frequently shift asset allocation based on their market views and for risk management.

Return targets tend to be cash + 500 basis points. Target risk, as measured by standard deviation, is generally below 10%. Realized risk is even lower and standard deviation has been as low as 5% in recent years. Beta in relation to the S&P 500 tends to be in the 0.25 range.

Long/Short Equity funds emphasize their long strategy, with short-selling as an additional feature.

There are often entire sectors or industries that are either limited in terms of exposure, or ignored entirely.

Portfolio turnover is often modest. But if you look deeper, turnover rates are elevated because of short-selling. Short-selling time horizons tend to be considerably shorter than those used for long positions.

Net exposure to equities tends to center on the 30% to 50% range, and betas are generally in the 0.5 range.

Market – Neutral funds. The largest funds in this category are mostly merger and arbitrage – related funds.

So how do these investment processes match up with your firm? Could your firm become as successful as these funds by focusing on one of these three sub - categories? Could your investment team also mirror the investment processes that have already attracted a lot of assets so far?

Sharpe Ratios – They Are Making Money for Clients (Source: Morningstar)

There are some extraordinarily good Sharpe ratios evident amongst the largest alternative funds.

Fund Name	Sharpe Ratio (highest reported for a share class)
1. AQR Managed Futures Strategy	.85
2. John Hancock Global Absolute Return	.59
3. Gateway	.71
4. Boston Partners Long - Short	.90
5. Diamond Hill Long - Short	.71
6. Merger	.54
7. PIMCO Emerging Markets Currency	-1.03
8. Calamos Market Neutral Income	.61
9. Natixis ASG Global Alternative	.35
10. AQR Multi Strategy Alternative	1.33
11. Natixis ASG Managed Futures	1.19
12. Principal Global Strategy	.60
13. AQR Style Premia Alternative	-
14. Catalyst Hedged Futures	.44
15. Neuberger Berman Long - Short	.33
16. GMO SGM Major Markets	.70
17. PIMCO RAE Worldwide Long - Short	-
18. Arbitrage	.87
19. Mainstay Marketfield	-.87
20. PIMCO StocksPlus Short	-1.44
21. Gotham Absolute Return	.73
22. William Blair Macro Allocation	.29
23. Blackrock Global Long – Short Equity	.57
24. Swan Defined Risk	.63
25. Goldman Sachs Multi Manager Alternative	-
26. Gabelli ABC	1.34
27. Dreyfus Dynamic Total Return	.61
28. Putnam Absolute Return	.41
29. Litman Gregory Masters Alternative Strategy	.53
30. AB US Select Long - Short	.74
31. LoCorr Market Trend	-
32. Equinox Campbell Strategy	-
33. Vanguard Market Neutral	1.37
34. Franklin K2 Alternative Strategy	-
35. Oppenheimer Fundamental Alternative	1.51
36. Putnam Absolute Return 500	.50
37. GMO Special Opportunities	-
38. Neuberger Berman Absolute Return Multi Alternative	0
39. John Hancock Absolute Return Currency	.33
40. Goldman Sachs Absolute Return	.45

A Lot of These Funds Are Exposed to the Equity Factor (Source: Morningstar)

The very largest funds are leveraged to equity beta and have benefitted from the current bull market.

Fund Name	Equity Beta (highest reported for a share class)
1. AQR Managed Futures Strategy	1.47
2. John Hancock Global Absolute Return	2.36
3. Gateway	1.70
4. Boston Partners Long - Short	1.64
5. Diamond Hill Long - Short	2.14
6. Merger	1.23
7. PIMCO Emerging Markets Currency	32.08
8. Calamos Market Neutral Income	-0.01
9. Natixis ASG Global Alternative	.84
10. AQR Multi Strategy Alternative	-0.04
11. Natixis ASG Managed Futures	.85
12. Principal Global Strategy	.38
13. AQR Style Premia Alternative	-
14. Catalyst Hedged Futures	-0.05
15. Neuberger Berman Long - Short	.46
16. GMO SGM Major Markets	.21
17. PIMCO RAE Worldwide Long - Short	-
18. Arbitrage	.05
19. Mainstay Marketfield	.38
20. PIMCO StocksPlus Short	-.78
21. Gotham Absolute Return	.68
22. William Blair Macro Allocation	.68
23. Blackrock Global Long – Short Equity	-0.03
24. Swan Defined Risk	.52
25. Goldman Sachs Multi Manager Alternative	-
26. Gabelli ABC	.01
27. Dreyfus Dynamic Total Return	1.06
28. Putnam Absolute Return	.56
29. Litman Gregory Masters Alternative Strategy	.41
30. AB US Select Long - Short	.60
31. LoCorr Market Trend	-
32. Equinox Campbell Strategy	-
33. Vanguard Market Neutral	.55
34. Franklin K2 Alternative Strategy	0
35. Oppenheimer Fundamental Alternative	.26
36. Putnam Absolute Return 500	.39
37. GMO Special Opportunities	-
38. Neuberger Berman Absolute Return Multi Alternative	.48
39. John Hancock Absolute Return Currency	-14.30
40. Goldman Sachs Absolute Return	.65

The Sponsors of Some of the Biggest Funds

(Source: Morningstar)

Fund families that have a record of asset growth and strong and consistent investment out – performance have also had success in the alternatives product category.

Fund Family	5 Year Growth in Total Fund Family AUM	Number of Years (of last 5) when the Fund Family's Investment Returns Have Exceeded Weighted Benchmark
AQR	Positive	5/5 Years
John Hancock	Positive	4/5
Diamond Hill	Positive	5/5
Principal	Positive	5/5
GMO	Positive	4/5
Gotham	Positive	4/4
Blackrock	Positive	4/5
Dreyfus	Positive	4/5
Alliance Bernstein	Positive	5/5
LoCorr	Positive	4/5
Equinox	Positive	3/4
Vanguard	Positive	5/5

Mid – Sized Fund Families With Track Records of Alpha Generation & Growth in AUM Over the Last 5 Years

(Source: Morningstar)

The fastest growing mid – sized mutual fund families – those with AUM between \$10 and \$100 Billion – have also had strong investment performance. On a weighted average basis, they often consistently outperform their own benchmarks according to Morningstar. They should be well positioned to capitalize on the interest in the alternatives fund category.

Fund Family	5 Year Growth in Family AUM	Number of Years (of last 5) when the Fund Family Investment Returns Have Exceeded Weighted Benchmark
Robeco	Positive	4/5 Years
Primecap Odyssey	Positive	4/5
Baird	Positive	5/5
AQR	Positive	5/5
Guggenheim	Positive	3/5
Henderson Global	Positive	5/5
Parnassus	Positive	5/5
Diamond Hill	Positive	5/5
SunAmerica	Positive	3/5
Harding Loevner	Positive	4/5

Mid – Sized Fund Families and Alternatives Funds

A number of fast growing mid – sized mutual fund families with strong investment performance have capitalized on their success by offering alternatives funds.

Fund Family (Ranked by 5 Year Growth in AUM)	Alternatives Fund Available?	All Funds Listed by Morningstar
Robeco	Yes	7
Primecap Odyssey	No	3
Baird	No	12
AQR	Yes	33
Guggenheim	Yes	20
Henderson Global	Yes	13
Parnassus	No	6
Diamond Hill	Yes	10
SunAmerica	Yes	18
Harding Loevner	No	7

Takeaways

- Alternative mutual fund products continue to attract attention from both investors and fund families.
- While returns have been modest and the largest funds have had significant leverage to equity returns, Sharpe ratios are high which bodes well for the future of the alternatives category.
- Marketing and investment success across other product categories are predictive of success in the alternative fund space as well. Many fund families have the requisite skills to be successful in introducing new alternative products.

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Russell has led 5 investment groups in his career. Prior to establishing his own firm, Russell was the CEO of The Marco Consulting Group, one of the largest institutional investment consulting firms, with a significant CIO outsourcing business. Previously, he was the EVP of AMCORE Bank, and led the Wealth Management Group which was one of the 60 largest bank wealth managers in the U.S. Earlier, Russell was the President and CEO of ABN AMRO Asset Management Holdings, Inc., which managed \$75 billion in assets, and was the U.S. investment management affiliate of ABN AMRO Bank. Russell was promoted to this position after having been the CEO of ABN AMRO Asset Management Canada, Inc. He was previously a Vice – President and Partner of Beutel Goodman, Inc., one of Canada’s largest investment counseling firms. His first leadership position was as Vice – President, Bank of Nova Scotia, where he led the investment management of the Bank’s own pension fund, and a family office portfolio.

Earlier in his career, he held positions as an institutional investment consultant, in institutional equity sales and as a precious metals portfolio manager.

Russell has an MBA in Investment Finance and Marketing from York University, and he has a BA in Industrial Relations from McGill University. He also attended the Advanced Management Program at INSEAD in France.

He has earned the Chartered Financial Analyst designation, and has attended both the Financial Analyst’s Seminar and the Investment Management Workshop. Russell has also acquired the Certified Financial Planner™ certification. He previously held Series 7 and 24.

Russell has been a director of several for-profit and not for profit boards, and he is a member of numerous non-profit, civic and industry organizations.

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