

Ivy Asset Strategy Fund

Analysis by Kevin McDevitt
CFA

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Prospectus Summary and Analysis

Whatever its role in May's "flash crash," that event revealed a crack in Ivy Asset Strategy.

Whether or not this fund caused or exacerbated the May 6 crash, that episode showed a potential pitfall of its rapid-fire hedging strategy. Lead manager Michael Avery and his team often hedge a large portion of the fund's equity portfolio, typically using futures contracts. He frequently adjusts these positions, often making significant changes to the fund's net equity exposure. Timing such trades can be difficult, though, as short-term market moves are notoriously difficult to predict.

Such trades tripped up the fund in May. It entered 2010 with a nearly 80% net equity weighting. Avery reversed course in the first two months of the year, though, fully hedging the fund's U.S. exposure. He then changed course again in April, removing many of these hedges just before the market scare in May. Avery re-established these hedges as the market fell on May 6, but that limited the fund's participation in the end-of-day rally somewhat. As a result, the fund dropped 8.4% in May, while its average world-allocation peer fell 6.2%. Currently, about half of the fund's 83% equity position is hedged, leaving net exposure at about 37%.

This remaining equity exposure is turbo charged. Asia represents about two thirds of its net equity, the bulk of which is in China. Offsetting this position somewhat is the fund's 12% holding in gold bullion, which has provided solid ballast.

The larger issue here is more uncertainty than risk. Its great long-term record and reasonable risk scores show that Avery's bold strokes have paid off over time. The problem is that these dramatic shifts make it difficult to know how the fund is positioned or where it may be heading. This makes it somewhat challenging to use the fund within a broader portfolio. Investors must be willing then to accept some unknown unknowns. Avery and his team, though, have shown that this can be a worthwhile trade-off. ■■

Morningstar's Approach to the Ivy Asset Strategy Fund

▶ **Kevin Mcdevitt, CFA**
Senior Fund Analyst

Conference Phone: 800 549-9585

Access Code: 8099010

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Was blaming Waddell political?

- ▶ It appears that fingering Waddell was politically motivated particularly since the trades executed post flash crash. Can you speak to that?

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Did Ivy Asset Strategy suffer a realized loss?

- ▶ How much of a realized loss did the fund suffer as a result of the trade(s)?

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Trading volume on the day of the flash crash

- ▶ Ivy's trade during the flash crash was less than 1% of the trading volume on that day and is a trade that they have executed before. There is no direct causal link between the trade and the flash crash and yet you are now questioning Ivy's hedges?

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Was the trade to hedge equity made without regard for price?

- ▶ Was the trade to hedge equity on May 6 placed as the SEC describes--with a program that sold very quickly without regard to price? If so, why?
- ▶ Should we be concerned about the fund's ability to execute effectively on management decisions?



Have operations or trading strategy changed?

- ▶ Operationally does the fund send trades through a sell side desk, specifically for futures contracts, and if so do they use multiple desks or do they primarily use one?
- ▶ And has their trading/execution strategy changed or been altered since the flash crash?



How can clients be protected in down markets?

- ▶ If you managed a mutual fund, how would you protect your clients during down markets and how would you be positioned right now?



Thoughts on a fund's style-box

- ▶ From my experience it appears your firm has a much more favorable opinion of funds that can be placed in a traditional style-box. With that being said can that explain some of your skepticism of a fund that has the ability to go anywhere, any asset class?



Concerns about holding the fund

- ▶ Do we sell the fund?

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The market's structure and its ability to handle volume

- ▶ How would you characterize the structure of the market and its ability to handle sudden increases in volume?
- ▶ Reports by firms like Nanex make it appear that HFT & market structure were more a cause than Waddell & Reed, what is your opinion on this?

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More information

Contact:

- ▶ Kevin McDevitt, CFA
Senior Fund Analyst
kevin.mcdevitt@morningstar.com
- ▶ Matt Eckstein
matt.eckstein@morningstar.com

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