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Alternative Investments Observer

MORNINGSTAR®

Commodities: Just Another Asset Class, or Alternative Investments?

The new view on commodity investing.

by
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The investing world, up until the past decade, involved only stocks, bonds, and cash. If people invested in commodities at all, it was generally through stocks. The debut of the first commodity futures mutual funds in 1997 and the creation of the first physical commodity exchange-traded fund in 2004, however, changed everything. The price gyrations of commodities such as gold and crude oil are now regularly discussed in the mainstream media, and total assets in commodity ETFs have ballooned. They grew from $2.1 billion at the end of 2003 to $150.4 billion at the end of 2011, with significantly more assets in futures-tracking and physical-commodity funds than in equities. (See Exhibit 1.) SPDR Gold Shares **GLD** itself has accumulated more than $73 billion in assets (as of Feb. 29), making it one of the top-five largest ETFs.

Investments in commodity mutual funds have also grown over the same time period, though not as much—from $16.4 billion to $137.6 billion. Investor preferences have demonstrated the same shift out of commodity-related equities and into futures-based strategies, as evidenced by PIMCO Commodity Real Return Strategy **PCRAX**, which boasts more than $23 billion (as of Feb. 29).

So, are commodities still alternative investments or have they morphed into a traditional asset class, on par with stocks and bonds? According to the 2011 Morningstar/Barron's Alternative Investment Survey of institutions and advisors, the resounding answer is that commodities are alternatives. But the devil is always in the details.

A Brief History of Commodity Investing

First, it is useful to understand the evolution of commodity investing. Prior to the establishment of the Commodity Futures Trading Commission in 1974, which began to regulate all futures contracts (including the first financial futures contract in 1975), speculation or investment in commodities was not widespread. It was limited to a few obscure public commodity pools or private hedge funds (which accepted only wealthy investors). The eight commodity-oriented mutual funds that existed before 1990 invested in commodity-related stocks rather than commodity futures.

Then came the commodity futures indexes. The Goldman Sachs Commodity Index (created in 1991 and now termed the S&P GSCI) was not originally designed to be an investable product—the weightings of the underlying commodity contracts are linking to factors such as global production instead of attempting to diversify commodity exposure, and the index tracks only the front-month futures contract

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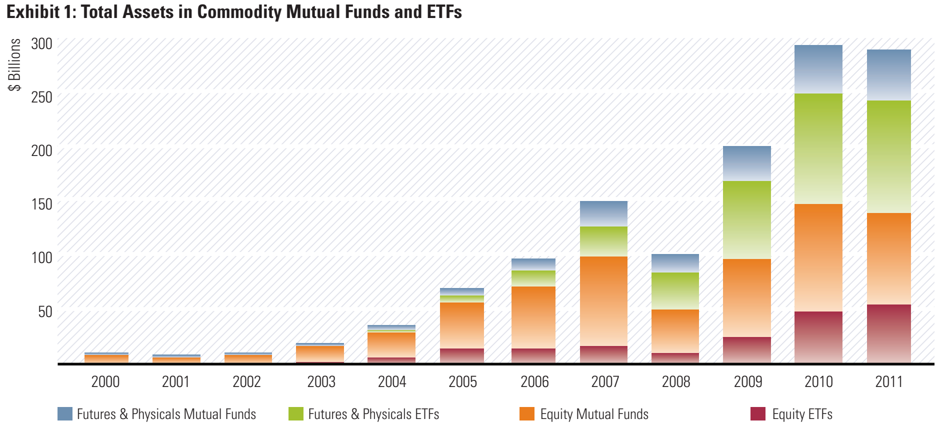
Exhibit 1: Total Assets in Commodity Mutual Funds and ETFs



(which can result in negative roll yield when the contracts are in contango). The DJ-AIG Commodity Index (created in 1998 and now termed the DJ-UBSCI) is very similar. Despite these drawbacks, the S&P GSCI and the DJ-UBSCI remain the stated benchmarks for 19 of the 30 funds and 92% of the $52 billion in assets in Morningstar's long-only commodities broad-basket category.

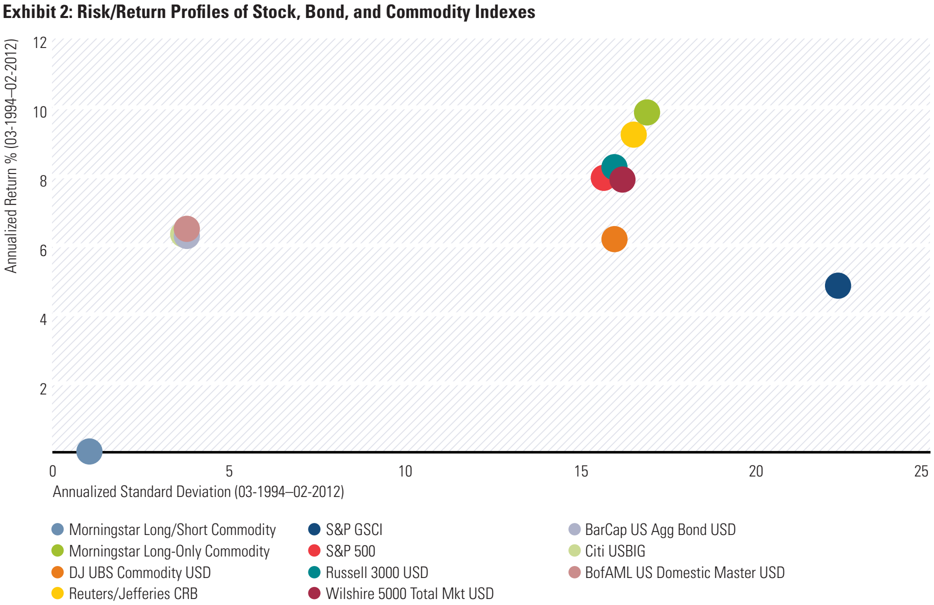
In 2004, commodities became available in exchange-traded funds. Out of the 197 commodity-related ETFs now available (in the United States as of Feb. 29), SPDR Gold Shares is by far the largest—even larger than the 30 commodities broad-basket mutual funds combined. Finally, beginning in 2007, strategies taking long and short positions in commodity futures (as well as financial futures in many cases) became available to the masses in mutual fund and exchange-traded structures rather than private pools. There are now two exchange-traded products (ELEMENTS S&P CTI ETN **LSC** and WisdomTree Managed Futures **WDTI**) and a category of approximately 30 such mutual funds, which hold about $9 billion in assets (as of Feb. 29, 2012).

Alternative Investing, Morningstar Style

Just because commodity investing has become widely accessible doesn't mean that investors agree on how to invest in them—as a traditional core asset class holding or as part of the alternative investments bucket.

Most people agree on the definition of an asset class, though. An asset class consists of investments that exhibit similar risk and return characteristics, and there are standard ways to benchmark them. Stocks, bonds, and cash have long fit into this definition, but over the past decade, the list has grown, depending on whom one asks. Morningstar's Paul Kaplan, director of quantitative research, for one, believes that commodities are an asset class, but there is "no such thing as a commodity beta.[1]" Kaplan argues that because commodities are accessed primarily through futures contracts, of which there is no market capitalization (for every long futures contract there is an offsetting short position), and because each futures index or strategy, depending on how it is constructed, generates different returns and risk from changes in futures prices and from the roll yield (which occurs when replacing an expiring contract with a farther-out contract to maintain a futures position), defining a commodity asset class is difficult. The proof is in the pudding. Exhibit 2 demonstrates the varying risk/return profiles of commodity indexes, versus the more stable profiles of various stock and bond indexes.[2]

Exhibit 2: Risk/Return Profiles of Stock, Bond, and Commodity Indexes



Even more nebulous is the definition of alternative investments. If investors can't even agree on what an asset class is, it is very difficult to come to a consensus on what an "alternative" to those asset classes is. Essentially, how one defines alternatives depends on how one thinks about commodities.

Morningstar believes that alternative investments are those that represent asset classes or trading styles that are not found in traditional portfolios, as well as investments that are particularly illiquid. Commodities could fall under the definition in all three cases. For example, a "60/40" portfolio consists of only stocks or bonds. In that case, any type of investment in commodities would be alternative. Second, thanks to futures contracts and exchange-traded funds, investors can take both long and short positions in commodities, and therefore these trading schemes could be considered alternative, even to an investor who has long-only commodity investments. Finally, investors can invest directly in and hold or store physical commodities (timberland or gold bars, for example). These direct investments present liquidity restrictions and therefore could be considered alternative.

Morningstar also believes that the definition of an alternative investment changes over time as more and more people adopt an investment as standardized. Whereas commodities may have once been considered alternative investments by all, this stance

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1 Kaplan, Paul Ph.D. 2011. *Frontiers of Modern Asset Allocation.* (Foreword by Laurence B. Siegel.) Hoboken, N.J.: Wiley, John & Sons, Inc.
2 Exhibit 2 is an updated version of the chart found in Kaplan's book.

has surely progressed as investor awareness and investment vehicle accessibility has dramatically increased.

The Evidence

The evidence indicates that most investors, no matter what their sophistication level, believe that commodities are alternative investments. As the sophistication level increases, however, so changes the viewpoint on commodities.

First, we'll start with the very least sophisticated of investors, retail investors in target-date mutual funds. In 2006, the Department of Labor designated target-date funds "Qualified Default Investment Alternatives" to cash or money market vehicles in retirement accounts. The theory was that many retail investors would never reach their retirement goals, as their retirement account assets too often sat in cash (the default option in many retirement plans). By changing the default option to a diversified portfolio that progresses over time (theoretically getting less risky as retirement approaches), unsophisticated retail investors would at least have a chance at funding their retirement needs.

Most target-date funds consist of stocks and bonds. Per Morningstar's 2011 industry survey of target-date series funds[3], however, a few of the largest 21 target-date fund families have recently branched into commodities. Five allocated to long-only commodity-futures-based strategies, in the range of 5.9%–9.4%, while six families allocated to long-only equity-based commodity strategies in the range of 2.8%–5.8%. These investments were considered "alternative" by the fund families, as supported by their small allocations.

Next, we'll look at advisors and institutions. As part of the 2011 Morningstar/Barron's Alternative Investment Survey, we asked institutional investors and advisors: Are commodities alternative investments? Sixty-six percent of institutions and 78% of advisors responded "yes." Clearly, both groups lean toward classifying commodities as alternatives. But the free responses (to the questions, "How are you gaining exposure?" and "What strategies are you employing?") demonstrated varying opinions at varying levels of sophistication. (If you missed the survey, feel free to send your comments to: nadia.papagiannis@morningstar.com).

Institutions that believe commodities are alternative primarily gain access to commodities through futures-tracking ETFs. But about 25% of the "yes" respondents invested in some sort of long-short commodities strategy, while a small percentage even invested directly in commodities such as farmland or timberland. Those institutions that do not believe commodities to be alternative investments primarily responded that they do invest in commodities but consider it a core allocation.

Advisors' responses indicated a slightly lower level of sophistication. Those agreeing that commodities are alternative primarily gained access to commodities through futures-based ETFs, similar to institutions. About 22% of the yea-sayers also indicated that they invested in long-short commodity strategies. Some advisors, however, are still gaining access to commodities primarily through equities. Furthermore, many of the advisors who do not believe commodities are alternatives simply did not invest in commodities at all.

Conclusion

So, it appears that all forms of commodity investing are still considered alternative by many investors, including both institutions and advisors. It appears, however, that both types of investors are becoming more sophisticated and looking to long-short trading strategies as a means of obtaining alternative commodity exposure, rather than standard long-only investing. In a few years' time, the views on commodities as alternative investments will undoubtedly change.

3 Morningstar® Target-Date Series Research Paper: 2011 Industry Survey. http://corporate.morningstar.com/US/documents/MethodologyDocuments/ResearchPapers/TargetDateSeriesResearch2011.pdf

Quant Corner: The Euro Is Already Dead

Asset allocators can no longer look to the euro as the basis for a risk-free asset.

by
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One of the most basic considerations for any investors considering the asset allocation of their portfolio is how to divide their portfolio between risk-free and risky assets. However, this raises the question: What is a risk-free asset? While there is no simple answer to this question, financial economics has always held that since government-issued debt is generally free of default risk, it is a reasonable proxy for a risk-free asset so long as investors eliminate interest-rate risk by matching the duration of the government bond with their investment horizon.

In the modern era, in most developed economies, and in many emerging economies, the default-free ideal was realized by the emergence of pure fiat national currencies. This system gives each national government virtually unlimited power to issue debt, which the bond markets regard as virtually free of default risk. This is because each national government has the power to persuade its central bank to increase the money supply and so devalue its debt with respect to the prices of goods and services. Even the supposedly independent Fed acquiesced to U.S. fiscal policy in the 1960s and 1970s, leading to the highest rate of U.S. inflation in the 20th century and a prolonged decline in the values of U.S. government bonds.

Until the introduction of the euro, each European country had both its own monetary and fiscal policy, resulting in a wide variety of inflation rates and government-bond yields across the continent. The promise of the euro was to bring uniformity to inflation and interest rates across the eurozone without a corresponding convergence of fiscal policy. Criticisms of the scheme were dismissed in a drive to bring about monetary union at what was considered a unique historical opportunity to do so.

The plan for the single currency was agreed upon with the signing of the Maastricht Treaty on Feb. 7, 1992, resulting in the launch of the common currency and the new monetary authority, the European Central Bank, on Jan. 1, 1999.

Until 2009, the euro seemed to deliver its promise. As Exhibit 1 (next page) shows, from early 1992, when the Maastricht Treaty was signed, until the end of 1998, government-bond yields converged as predicted. Then until 2009, they remained virtually the same.

However, within the apparent success of the single currency lay the cause of its own demise. Specifically, because the governments of the poorer countries were able to borrow at the same rate as the richer countries, in effect the governments of the poorer countries came to be subsidized by the richer countries. A basic law of economics is that if you subsidize an activity you get more of it, and because the poorer countries were able to borrow and spend at subsidized interest rates, they did just that. This became an issue most particularly for the Greek government, which has always had difficultly collecting taxes from its citizens.

The late economist Herbert Stein famously stated that "if something cannot go on forever, it will stop." The unity of eurozone government-bond yields was certainly subject to this law and, as Exhibit 1 shows, did indeed stop in 2009. Eventually reality emerged in the bond markets that countries with conflicting fiscal policies cannot have the same government-bond yields. However, there is an important difference between the diversity of yields before the euro era and those of today. In the past, differences of yields were largely due to differences in the rates of inflation across countries that were rooted in differences in monetary policy. Because today the poorer eurozone governments cannot set their own monetary policies, the only option that they have is to

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Exhibit 1: Long-Term Government-Bond Yields for Selected Eurozone Countries

Sources: Morningstar EnCorr, International Monetary Fund

default (which the Greek government has already effectively done, albeit not yet in name). Hence, the differences in yield are now due to differences in default probabilities.

What this means for investors is that they cannot lump all eurozone government debt into a single asset class. It is now more important than ever to look at each government's creditworthiness on its own merit. Fortunately, the bond markets are already doing this so that investors can use yield spreads as guides as to which country's debt they can regard as "risk-free" and which ones are risky. And they can do this without the aid of the sovereign credit ratings that have proved to be irrelevant.

There is much debate about the future of the euro. At the 2012 Morningstar Investment Conference in Vienna, two leading experts took opposite points of view. Professor Peter Bofinger of University of Wurzburg argued that the euro would survive, while Professor Andrew Clare of Cass Business School in London argued that it must ultimately at least partially unravel. What was interesting was that these two economists agreed on the economics of the eurozone. Namely, they agreed that without some sort of fiscal union, the euro cannot continue in its current form. The source of their differences lies in their political outlook, with Professor Bofinger arguing that the politicians will agree to a fiscal union while Professor Clare argued that voters of the various European countries would never accept such a loss of national sovereignty.

We can understand the underlying economic problem of the eurozone by referring to the theory of "optimal currency zones" as articulated by Nobel Prize-winning economist Robert Mundell. According to Mundell, in order for it to be optimal for a group of countries to have a single currency, the following conditions must hold:

1. There must be labor mobility so that people are willing and able to relocate throughout the zone to access jobs.
2. There must capital mobility across the zone.
3. The countries within the zone must have similar business cycles.
4. There must be a risk-sharing system in place across the zone so that money can be redistributed geographically when necessary.

What is striking about the eurozone is the absence of these conditions, thus making it clear that the creation of the euro was motivated by politics rather than economics.

Whatever the politicians may or may not do to save the euro, what is most important to investors are the choices that they now face across the investment landscape. What is apparent from the sovereign-bond yield curves is that while the euro might still exist as the common medium of exchange across the zone, it has ceased to exist as the basis for a pan-European risk-free asset. As far as asset allocation is concerned, the euro is already dead.

Morningstar Product Spotlight: Morningstar Office℠

Analyzing alternative investments in Morningstar Office.

by
Josh Charney
Alternative Investment Analyst

Morningstar Office℠ provides advisors with a powerful portfolio-tracking tool and the ability to produce data-rich reports in a client-friendly format. Yet, far too few advisors have time to venture outside their daily keystrokes and miss out on the software's in-depth research capabilities. One area where advisors could brush up is in alternative investments, as there is a swath of products available but few places to turn to for reliable research. (Morningstar recently launched an educational website for advisors, http://advisors.morningstar.com/advisor/alternative-investments.htm.) In this article, we showcase how Morningstar Office can be used to gain valuable insight into the world of alternative investments.

Office as a Screening Tool

To start the search in the research module, we entered the seven open-ended alternative categories, which are: bear market, currency, long/short equity, managed futures, market neutral, multialternative, and nontraditional bond. (See Exhibit 1.) We limited this search to only mutual funds, but the alternative exchange-traded fund categories are the same as the ones listed, plus: volatility, trading-miscellaneous, trading-leveraged equity, trading-leverage debt, and trading-inverse commodities.

The search criteria below can be used to screen for alternative mutual funds rated 4 stars and above and open to investors. When running the screen, it's important to place commas to separate the "or" from the "and" blocks and to eliminate multiple share classes.

The search produces 17 results across the long/short, market-neutral, multialternative, and non-traditional-bond categories. Currency and managed-futures funds lack star ratings because of short track records and not enough constituents. (At this time, Morningstar does not intend to rate bear-market funds, as most of the funds in the category are index-based.) If advisors seek a fund in one of these categories, they can eliminate the Morningstar Rating screen and instead screen on other factors. Other factors we can add to this search include assets under management of more than $100 million (field name: fund size) or a track record of at least four years (field name: inception date). These screens would eliminate funds that were not around during the crisis or that may not have sufficient infrastructure (research or operational resources) to support large inflows.

Sifting Through the Data

After the search is populated, it's best to move the funds to an investment list for analysis by

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Exhibit 1: Alternative Mutual Fund Search

Open | Insert | Delete | Clear All | Export | PDF | Save As | Feedback

	Rel	(	Field Name	Operator	Value	)
1	---	(	Morningstar Category	=	Bear Market	
2	Or		Morningstar Category	=	Currency	
3	Or		Morningstar Category	=	Long/Short Equity	
4	Or		Morningstar Category	=	Managed Futures	
5	Or		Morningstar Category	=	Market Neutral	
6	Or		Morningstar Category	=	Multialternative	
7	Or		Morningstar Category	=	Nontraditional Bond	)
8	And	(	Oldest Share Class	=	Yes	
9	And		Closed to New Inv	=	No	
10	And		Morningstar Rating Overall	>=	4	)

View Field Name: By Category / Alphabetically

Items Searched: 26394 **Items Found:** 17 Run Search

Help OK Cancel

selecting the entire group and going to **Action –> Save As –> Investment List**. Once moved to an investment list, we can add benchmarks and category averages to the list to analyze the funds. (See Exhibit 2.)
For simplicity, we only evaluated long/short equity funds, but the general idea of this walk-through can be applied to the other alternative categories.

Relevant data points to consider adding would be:

1. Annual returns by year
2. One-, three-, and five-year returns
3. Alpha
4. Beta
5. Standard deviation
6. Sharpe ratio
7. Upside/downside capture
8. Morningstar Rating for three years and five years
9. Equity Style Box (long and short)

Because alternative funds come in all shapes and sizes, it's important to gain a general sense for a fund's risk attributes. Even in the long/short equity category, funds can vary greatly over these characteristics. For example, Pyxis Long/Short Equity **HEOAX** has exhibited a 30% net equity exposure on average over the past three years (as measured by the fund's monthly beta to the S&P 500 through March 31), but Wasatch Long/Short's **FMLSX** stock market exposure was more than double, meaning that it took on more risk to generate its returns. On a risk-adjusted basis, Pyxis has outperformed, as demonstrated by its positive alpha over the period. (The funds differ slightly in what they invest in, however. Wasatch is focused on large-capitalization stocks, and Pyxis is more mid-capitalization-focused, so the S&P 500 benchmark is more appropriate for Wasatch.)

Another interesting data point to analyze is how the funds perform in different market environments. Diamond Hill, for example, fell much further than its peers in 2008 because of the fact that management covered its shorts early and does not hedge using ETFs or futures. Over the past three years, however, Wasatch Long/Short has performed worse than Diamond Hill Long/Short **DIAMX** in down markets, as demonstrated by its 70% downside capture ratio. Marketfield **MFLDX**, on the other hand, has the best upside capture ratio, which explains its current 5-star rating.
It's important to isolate funds that can capture market gains in addition to limiting losses.

Exhibit 2: Alternative Mutual Fund Investment List

	Name	Annual Ret 2008 Base Currency	Annual Ret 2009 Base Currency	Beta 3 Yr (Mo-End) Risk Currency	Sharpe Ratio 3 Yr (Mo-End) Risk Currency	Alpha 3 Yr (Mo-End) Risk Currency	Upside Capture Ratio 3 Yr (Mo-End) Risk	Downside Capture Ratio 3 Yr (Mo-End) Risk
	Benchmark:Morningstar US Market TR USD	(37.03)	28.45		1.38			
1	ASTON/MD Sass Enhanced Equity N		27.34	0.63	1.50	3.65	66.45	46.51
2	Marketfield	(12.88)	31.08	0.64	1.53	5.01	77.71	63.87
3	Diamond Hill Long-Short A	(23.65)	17.93	0.61	1.11	(1.34)	53.74	52.16
4	Pyxis Long/Short Equity A	(10.48)	18.07	0.30	1.04	0.10	33.93	38.37
5	Schooner Fund A		23.60	0.57	1.52	2.68	60.04	44.88
6	Wasatch Long/Short	(20.93)	30.07	0.76	1.19	(1.15)	70.38	70.70
7	US OE Long/Short Equity	(15.40)	10.46	0.52	0.83	(1.63)	49.12	57.40
8	S&P 500 TR	(37.00)	26.46		1.38			

Exhibit 3: Alternative Mutual Fund Correlation Matrix

File Tools Help | New | Clipboard | PowerPoint | Create PDF | Export Excel | Send us feedback

Correlation Matrix

Action | Chart Settings | Edit Investments

Add Investment | Reset

Time Range 3 Year | Apr, 2009 - Mar, 2012 | Currency Base Currency | Frequency Monthly | View Holdings

Source Data Default | Period All | Benchmark | Threshold 0.00 %

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1	ASTON/MD Sass Enhanced Equity N															
2	Marketfield	0.80														
3	Diamond Hill Long-Short A	0.84	0.70													
4	Pyxis Long/Short Equity A	0.54	0.61	0.52												
5	Schooner Fund A	0.91	0.79	0.89	0.62											
6	Wasatch Long/Short	0.83	0.76	0.91	0.61	0.89										
7	US OE Long/Short Equity	0.79	0.74	0.91	0.72	0.88	0.93									
8	S&P 500 TR	0.86	0.82	0.89	0.74	0.91	0.92	0.96								
9																
10																
11																
12																
13																
14																
15																

Time Period: 4/1/2009 to 3/31/2012 | 1.00 to 0.60 | 0.60 to 0.20 | 0.20 to -0.20 | -0.20 to -0.60 | -0.60 to -1.00

Correlation Matrixes and Risk/Reward Charts
Morningstar Office is also a great tool for comparing correlations among funds and asset classes. Going back to the list of long/short equity funds, we created a correlation matrix by placing a check mark next to each of the funds and clicking **Action –> Charts –> Correlation Matrix** (to add the S&P 500, we clicked Edit Investments once inside the chart). In Exhibit 3, we can see that Pyxis Long/Short Equity has exhibited the lowest correlation to the S&P 500 over the past three years, which along with its positive Sharpe ratio means that this fund should improve a traditional portfolio's risk-adjusted returns. To compare Sharpe ratios or risk/reward across funds, we created a Risk/Reward chart by going to **Action –> Charts –> Risk/Reward**. Marketfield has a higher risk/reward profile (see Exhibit 4) but a higher correlation to equities.

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Building Model Portfolios

Subscribers of Morningstar Office can also build model portfolios. Adding alternative investments to model portfolios allows users to glean insight into how these funds would have added, or detracted, from client portfolios. We started by creating a basic 60/40 portfolio in the investment planning section, entering the Barclays Aggregate Bond Index (40%) and S&P 500 (60%) in the holdings. The model we created was a variable model, meaning we could adjust the rebalance frequency and even change the model's holdings over time.

Next, we reduced the equity allocation to 55% and added 5% to Pyxis Long/Short. Indeed, on a five-year basis (the fund's inception was in 2006), our portfolio's Sharpe ratio improved to 0.36 from 0.34. (See Exhibits 5 and 6.) The absolute performance of the portfolio also improved over the past five years. To visually demonstrate how the above model performed over time, an advisor could run a snapshot report by going to **Reports –> Analytical Reports –> Snapshot**, or he could generate a monthly rolling-return chart by selecting the securities and going to **Action –> Charts –> Rolling Return** (bar). Data from the rolling-return chart can then be exported into Excel to demonstrate how the model performed over certain time periods.

Conclusion

Morningstar Office can help advisors segregate the ugly from the investable when it comes to alternative investments. Because alternative investments demand a higher degree of sophistication, clients will appreciate it if advisors go the extra mile in their research. Morningstar Office is a useful tool to weed out the noise and to display the data in a manner that's both visually pleasing and easy to comprehend.

Exhibit 4: Alternative Mutual Fund Risk/Reward Chart

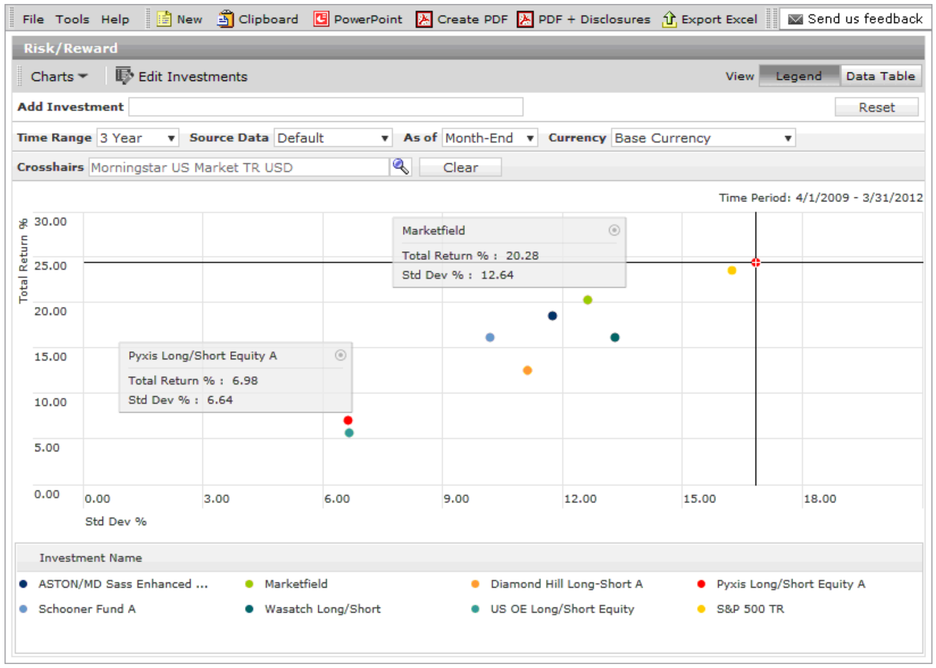


Exhibit 5: Standard 60/40 Model Portfolio

Risk and Return Statistics	3-Yr		5-Yr		10-Yr	
As of Date 3/31/2012	Portfolio	B-mark	Portfolio	B-mark	Portfolio	B-mark
Standard Deviation	9.46	16.23	11.62	19.08	9.59	15.99
Mean	17.15	23.42	4.36	2.01	5.31	4.12
Sharpe Ratio	1.72	1.38	0.34	0.15	0.41	0.22
MPT Statistics						
Alpha	3.29		2.24		1.78	
Beta	0.58		0.60		0.59	
R-squared	98.79		98.24		97.45	

Exhibit 6: Alternative Mutual Fund Model Portfolio (5% allocation to HEOAX)

Risk and Return Statistics	3-Yr		5-Yr		10-Yr	
As of Date 3/31/2012	Portfolio	B-mark	Portfolio	B-mark	Portfolio	B-mark
Standard Deviation	8.90	16.23	10.93	19.08	---	15.99
Mean	16.31	23.42	4.45	2.01	---	4.12
Sharpe Ratio	1.74	1.38	0.36	0.15	---	0.22
MPT Statistics						
Alpha	3.28		2.23		---	
Beta	0.54		0.57		---	
R-squared	98.59		97.88		---	

Industry Trends: Alternative Mutual Funds

The managed-futures rush continues.

by
Terry Tian
Alternative Investments Analyst

Alternative Mutual Funds

The velocity of managed-futures mutual fund launches is only getting faster, despite the category's dismal performance over the past few years. A mere five years ago, only one managed-futures mutual fund existed—Guggenheim (formerly Rydex) Managed Futures Strategy **RYMTX**. Since this niche investment strategy delivered chart-topping performance in 2008, investors have been piling into managed futures. Now there are more than 30 funds in the category, 13 of which launched just last year. In the first three months of 2012, six new managed-futures mutual funds came to the market, including Goldman Sachs Managed Futures Strategy **GMSAX**, Direxion Indexed Managed Futures Strategy **DXMAX**, Forward Managed Futures Strategy **FUTCX**, and three funds from Equinox—Equinox Eclipse Strategy **EECIX**, Equinox John Locke Strategy **EJLIX**, and Equinox QCM Strategy **EQQCX**. (All three are subadvised by single commodity trading advisors, or CTAs.) On the exchange-traded fund side, ProShares filed for three managed-futures ETFs last November, which would bring the total number of managed-futures exchange-traded products to five. Assetwise, although the managed-futures category is still one of the smallest categories—roughly $7.8 billion in assets as of Feb. 29—the growth rate is astonishing. The category almost doubled in assets last year (because of inflows of $3.6 billion), and it gathered another $378 million in the first two months of 2012.

The newly launched managed-futures offerings are unique for a couple of reasons. First, prior to this year, there were no single-manager CTAs. Equinox has paved the way for private hedge funds or CTAs to come to market in a 1940-Act vehicle while still charging hedge-fund-like fees (2% management and 30% performance fees in the case of the abovementioned Equinox funds). Second, these offerings, whether they are actively managed or third-party index-tracking, all follow strategies that diverge from the crowd. Whereas the original managed-futures funds were based on the S&P Diversified Trends Indicator, the new funds attempt to capture momentum in different ways. For example, Equinox Eclipse Strategy utilizes macroeconomic and fundamental inputs in the price-based momentum model. Equinox John Locke Strategy incorporates volatility expansion (profits from increased market volatility) and mean-reversion strategies into the trend-following algorithm. And Goldman Sachs Managed Futures Strategy incorporates short-term, intermediate-term, and long-term price trends.

For a while, the fate of managed-futures mutual funds was in limbo. The U.S. Commodity Futures Trading Commission had publicly announced its intention to squash futures-based mutual funds' exemption from commodity pool registration and regulations in 2010, and in February 2012, the final ruling came out. Mutual funds must now register as commodity pool operators, or CPOs, and they must disclose items such as underlying management and performance fees (in a break-even calculation) prominently in their SEC prospectus. Many of the disclosure details are still unclear, however, and the CFTC is requesting comments through April as to how to proceed. While the CFTC's ruling on managed futures was by no means a deal-breaker for mutual funds (many sponsors were already registered as CPOs), a future Internal Revenue Service ruling may be. In early February, Sen. Carl Levin openly questioned the validity of IRS private-letter rulings that have (in the past) allowed mutual funds to trade commodity futures in controlled foreign corporations, as Levin believes that this may be a form of tax evasion and that mutual funds trading commodities have caused increased volatility in commodities markets. These views have little basis in fact, however, so one hopes that Congress will come to its senses.

Fund Reports

Accuvest Global Long Short ETF

by **Nadia Papagiannis, CFA**

Advisor
Accuvest Global Advisors (subadvisor)

Advisor Location
Walnut Creek, California

Assets Under Management
$14.9 million (fund)

Inception Date
July 8, 2010

Investment Type
Exchange-traded fund

Morningstar Category
Long-short equity

Management
Accuvest Global Advisors became the subadvisor of this active ETF on Dec.1, 2011. Accuvest is a registered investment advisor founded in 2005 by David Garff to serve international high-net-worth and institutional clients. Prior to starting Accuvest, he spent 10 years as a consultant to Smith Barney, serving family offices, foundations, and endowments. Garff brought on Brad Jensen, who heads the firm's global strategy and manages portfolios. Jensen works concurrently for William Wright Associates, where he manages portfolios for non-U.S. foundations and families. Jensen and Garff are supported by head trader Chris Hayman, two analysts, and a chief compliance officer.

Strategy
As of Dec. 1, 2011, when the advisor and the strategy of this fund changed, this fund takes long and short positions in country- or region-stock index exchange-traded funds within the MSCI All Country World Index. The fund's investment universe is about 30 country ETFs, which it ranks on a monthly basis. The fund takes long positions in six to 12 of the top-third-ranked ETFs and short positions in three to 12 of the bottom-third-ranked ETFs. Currently, for every dollar position in long ETFs, the fund takes an equal position in short ETFs, and then management uses futures contracts (on the S&P 500, MSCI EAFE, and MSCI Emerging Markets indexes, for example) to achieve its target net-long exposure range of 20%–60% (until the SEC approves a net-long exposure using only ETFs). The goal of the strategy is to achieve positive returns from country selection, which the firm believes dominates sector selection.

Process
The monthly country-ranking process is both quantitative and qualitative. The firm uses a 40-factor system, which the advisor groups into four buckets: fundamental, momentum, valuation, and risk. Fundamental factors include percentage of sales growth and percentage of acceleration in OECD leading economic growth indicators. Momentum factors include 12-month price momentum. Valuation factors include price/earnings and price/book ratios, relative to a country's own history and relative to other countries. For these three buckets, the higher the measure, the higher a country is generally ranked. The risk factors look at currency risk and volatility. For currencies, management assembles a 30-by-30 matrix of currency pairs in the investment universe and attempts to assess the competitiveness and relative valuation of a country's currency, ranking countries with the least competitiveness and most overvalued currencies the lowest. For volatility, the firm looks at several measures (six-month volatility, or semistandard deviation, for example) and ranks the most risky countries at the bottom. The factors within each of the four buckets are approximately equally weighted and measured in local currency. Management reviews all factors once per year. On a weekly basis, management determines the fund's overall net stock exposure, based upon its qualitative assessment.

Risk Management
Management is highly focused on liquidity. It ensures the fund does not invest more than 3% in the outstanding shares of any ETF. It determines the liquidity of an ETF not just by the trading volume of the ETF, but also by the liquidity of its underlying stocks. For example, the fund does not invest in Israel or Ireland country ETFs because of their underlying lack of liquidity.

When creating shares, the fund may temporarily (overnight) invest in or short futures until it can assemble the basket of both long and short ETFs. Redemptions baskets are long ETFs and the cash value of the shorts.

Release date 03-31-2012

Accuvest Global Long Short ETF (USD)

Overall Morningstar Rtg™	Standard Index	Category Index	Morningstar Cat
— Long/Short Equity	S&P 500 TR	Russell 1000 TR USD	Long/Short Equity

Performance 03-31-2012

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2010	—	—	—	1.03	—
2011	-11.61	-7.08	-1.92	1.94	-17.88
2012	3.30	—	—	—	3.30

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Std Mkt 03-31-12	-3.64	—	—	—	-8.59
Std NAV 03-31-12	-4.03	—	—	—	-8.23
Mkt Total Ret	-3.64	—	—	—	-8.59
NAV Total Ret	-4.03	—	—	—	-8.23
+/- Std Index	-12.57	—	—	—	—
+/- Cat Index	-11.89	—	—	—	—
% Rank Cat	100	—	—	—	
No. in Cat	2	—	—	—	

Performance Disclosure

The Overall Morningstar Rating is based on risk-adjusted returns, derived from a weighted average of the three-, five-, and 10-year (if applicable) Morningstar metrics.

The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate; thus an investor's shares, when sold or redeemed, may be worth more or less than their original cost.

Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please call 877-843-3831 or visit www.advisorshares.com.

Fees and Expenses

Fund Expenses

Management Fees %	1.35
12b1 Expense %	0.00
Expense Ratio %	3.42
Prospectus Gross Expense Ratio %	1.59

Risk and Return Profile

	3 Yr	5 Yr	10 Yr
	—	—	—
Morningstar Rating™	—	—	—
Morningstar Risk	—	—	—
Morningstar Return	—	—	—

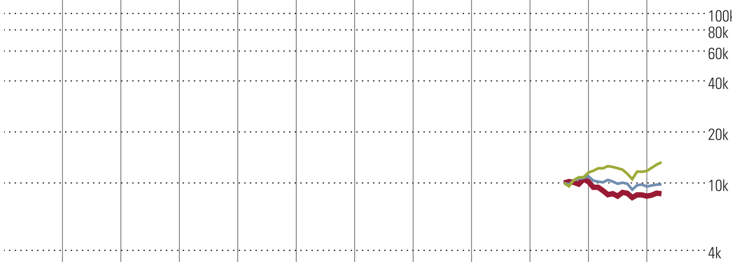
	3 Yr	5 Yr	10 Yr
Standard Deviation NAV	—	—	—
Standard Deviation MKT	—	—	—
Mean NAV	—	—	—
Mean MKT	—	—	—
Sharpe Ratio	—	—	—

MPT Statistics NAV	Standard Index	Best Fit Index
Alpha	—	—
Beta	—	—
R-Squared	—	—

12-Month Yield	—
30-day SEC Yield	—
Potential Cap Gains Exp	—
Leveraged	No
Leverage Type	—
Leverage %	100.00
Primary Prospectus Benchmark	Not benchmarked

Investment Style
Fixed-Income
Bond %

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	03-12
—	—	—	—	—	—	—	—	—	0	0	0



Growth of $10,000
- Accuvest Global Long Short ETF 8,632
- Category Average 9,807
- Standard Index 13,243

Performance Quartile (within category)

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	03-12	History
—	—	—	—	—	—	—	—	—	—	-17.29	3.05	Mkt Total Ret %
—	—	—	—	—	—	—	—	—	—	-17.88	3.30	NAV Total Ret %
—	—	—	—	—	—	—	—	—	—	-19.99	-9.29	+/- Standard Index
—	—	—	—	—	—	—	—	—	—	-19.38	-9.60	+/- Category Index
—	—	—	—	—	—	—	—	—	—	100	—	% Rank Cat
—	—	—	—	—	—	—	—	—	—	5	4	No. of Funds in Cat
—	—	—	—	—	—	—	—	—	-0.20	-0.24	—	Avg Prem/Discount %

Portfolio Analysis 03-29-2012

Asset Allocation % 03-22-2012	Net %	Long %	Short %
Cash	62.39	101.40	39.01
US Stocks	43.49	43.60	0.11
Non-US Stocks	-6.15	88.04	94.19
Bonds	0.00	0.00	0.00
Other/Not Clsfd	0.27	1.63	1.36
Total	100.00	234.67	134.67

Equity Style (Value Blend Growth; Large Mid Small)

Portfolio Statistics	Port Avg	Rel Index	Rel Cat
P/E Ratio TTM	12.5	0.83	0.86
P/C Ratio TTM	7.5	0.82	0.81
P/B Ratio TTM	1.6	0.74	3.44
Geo Avg Mkt Cap $mil	14109	0.26	0.41

Fixed-Income Style (Ltd Mod Ext; High Med Low)

Avg Eff Maturity	—
Avg Eff Duration	—
Avg Wtd Coupon	13.47
Avg Wtd Price	91.01

Credit Quality Breakdown —	Bond %
AAA	—
AA	—
A	—
BBB	—
BB	—
B	—
Below B	—
NR/NA	—

Regional Exposure	Stock %	Rel Std Index
Americas	56.7	0.57
Greater Europe	10.1	100.40
Greater Asia	33.2	—

Top Holdings 03-06-2012

Share Chg since 03-2012	Share Amount	Holdings: 4,200 Total Stocks , 4 Total Fixed-Income, 751% Turnover Ratio	% Net Assets
	36	S&P500 Emini Fut Mar12	16.92
	162,082	iShares MSCI Italy Index	-14.77
	200,207	iShares MSCI Japan Index	-13.74
	123,048	iShares MSCI Austria Investable Mk	-13.52
	65,096	iShares MSCI Spain Index	-13.40
	26,962	iShares MSCI South Korea Index	10.89
	18,354	iShares Russell 2000 Index	10.13
	10,475	iShares S&P 500 Index	9.92
	51,037	iShares MSCI Brazil Small Cap Index	9.84
	20,029	iShares MSCI Thailand Invest Mkt I	9.82
	39,977	Market Vectors Russia ETF	8.73
	18,420	iShares MSCI South Africa Index	8.64
	22	Mini Msci Emg Mkt Mar12	7.93
	15	Mini Msci Eafe Mar12	7.89
	15,183	iShares MSCI Brazil Index	7.09

Sector Weightings	Stocks %	Rel Std Index
Cyclical	**44.3**	**1.60**
Basic Materials	9.5	2.93
Consumer Cyclical	11.3	1.19
Financial Services	18.2	1.38
Real Estate	5.3	2.96
Sensitive	**38.4**	**0.83**
Communication Services	4.8	1.16
Energy	10.9	0.91
Industrials	10.6	0.91
Technology	12.0	0.65
Defensive	**17.4**	**0.67**
Consumer Defensive	8.2	0.72
Healthcare	5.9	0.53
Utilities	3.3	0.97

Operations

Family:	AdvisorShares	Ticker:	AGLS	Prem/Discount:	0.00
Manager:	Multiple	Incept:	07-08-2010	Mkt Price:	21.23
Tenure:	0.4 Year	Expiration Date:	—	Base Currency:	USD
Total Assets:	$14.9 mil	Exchange:	NYSE ARCA	Legal Structure:	Open Ended Investment Company
Shares Outstanding:	700.00k	NAV:	21.23	Backing Bank:	AdvisorShares Investments, LLC

Fund Reports

Eaton Vance Parametric Structured Absolute Return

by **Mallory Horejs**

Advisor
Eaton Vance Management

Advisor Location
Boston, Massachusetts

Assets Under Management
$10.7 million (fund)

Inception Date
Oct. 31, 2011

Investment Type
Mutual fund

Morningstar Category
Market neutral

Management
Parametric Portfolio Associates LLC, a majority-owned subsidiary of Eaton Vance, subadvises this fund. David Stein serves as the primary portfolio manager and is assisted by Thomas Seto. Stein joined Parametric in 1996 after working in research, development, and portfolio management positions at GTE Investment Management, Vanguard, and IBM Retirement Funds. Seto joined the firm in 1998 after heading up portfolio management for U.S. equity index strategies at Barclays Global Investors. The duo is supported by Timothy Atwill and Paul Bochey. Bochey focuses on the structured equity strategies, while Atwill specializes in the commodity and currency sleeves. Although the fund launched just last year, Parametric started running this strategy through separate accounts in May 1994.

Strategy

This multiasset class market-neutral fund attempts to generate alpha through portfolio construction. Management believes that many traditional asset class benchmarks contain too much concentration risk—nearly half of the MSCI Emerging Markets Index, for example, is allocated across Brazil, South Korea, and China; and the euro constitutes 58% of the U.S. Dollar Index **DXY**. By creating better indexes and rebalancing, Parametric strives to generate alpha. The fund invests in five asset classes through stocks, futures, and forward contracts: U.S. equity, developed international equity, emerging-markets equity, commodities, and currencies. Management starts with traditional benchmark indexes—the S&P 500 Index, the MSCI EAFE Index, the MSCI Emerging Markets Index, the Dow Jones-UBS Commodity Index, and the U.S. Dollar Index—and then calculates new target weightings for each index's constituents on a quarterly basis. The fund then uses swaps or shorts futures contracts related to these benchmarks to neutralize beta exposure (with the exception of the U.S. Dollar Index). Rebalancing provides an additional return source. Management does not target volatility, but standard deviation since inception has been 4.2% (using annualized daily data through April 10, 2012).

Process

Parametric follows a transparent, rules-based process for each of its five asset-class sleeves. For the three equity-oriented strategies, management diversifies country, sector, and stock exposures. In the emerging-markets-equity sleeve, for example, it divides approximately 25 countries into three tiers based on market size and liquidity and then equally weights countries within each tier. Next, it selects roughly 600 stocks across the countries using an optimization model that minimizes portfolio variance. David Stein rebalances the portfolio when the country weightings stray 20% to 40% from their targets, depending on the transaction costs. The international-equity sleeve employs a similar reweighting strategy, underweighting the largest countries in the MSCI EAFE Index, such as Japan, and overweighting smaller countries. The U.S.-equity sleeve focuses on adjusting sector exposures in the S&P 500, for example, underweighting technology stocks and overweighting utilities. Both developed-equity sleeves are rebalanced quarterly but can be adjusted intraquarter as well, if necessary. The two remaining strategies seek to provide broad exposure across commodity sectors and developed-markets currencies. The commodity sleeve invests in 22 commodity futures, equally weighting within three liquidity tiers. If sufficiently liquid, nonindex commodities can also be used. The currency sleeve makes equal-weighted investments in 11 currency forwards, avoiding countries that are illiquid or small or that have fixed-exchange rates. For both sleeves, the team rebalances monthly when contracts roll over, but they also adjust intramonthly if weightings stray 20% from the targets.

Risk Management

Management depends on the portfolio's high level of diversification as its primary risk-reduction tool—reducing concentration risk in these benchmarks allows them to create portfolios that are less volatile than the overall market. The strategy will face headwinds though when those assets most heavily represented in traditional benchmarks (the euro or crude oil, for example) continue to rise for long periods of time without any price reversals. Management does not take any risk with its derivatives collateral, investing it in six- to 12-month maturity U.S. Treasury bills. M

Eaton Vance Paramtrc Struct Abs Ret I (USD)

Standard Index	Category Index	Morningstar Cat
S&P 500 TR	BofAML USD LIBOR 3 Mon CM	US OE Market Neutral

Performance 03-31-2012

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2010	—	—	—	—	—
2011	—	—	—	—	—
2012	0.80	—	—	—	0.80

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	—	—	—	—	0.70
Std 03-31-2012	—	—	—	—	0.70
Total Return	—	—	—	—	0.70
+/- Std Index	—	—	—	—	—
+/- Cat Index	—	—	—	—	—
% Rank Cat	—	—	—	—	
No. in Cat	—	—	—	—	
7-day Yield	—				

Performance Disclosure

The Overall Morningstar Rating is based on risk-adjusted returns, derived from a weighted average of the three-, five-, and 10-year (if applicable) Morningstar metrics.

The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate; thus an investor's shares, when sold or redeemed, may be worth more or less than their original cost.

Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please call 800-262-1122 or visit www.eatonvance.com.

Fees and Expenses

Sales Charges

Front-End Load %	**NA**
Deferred Load %	**NA**

Fund Expenses

Management Fees %	1.00
12b1 Expense %	NA
Gross Expense Ratio %	**1.45**
Prospectus Gross Expense Ratio %	**1.45**

Risk and Return Profile

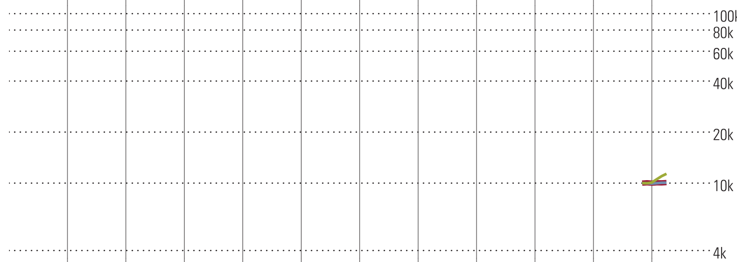
	3 Yr	5 Yr	10 Yr
	—	—	—
Morningstar Rating™	—	—	—
Morningstar Risk	—	—	—
Morningstar Return	—	—	—

	3 Yr	5 Yr	10 Yr
Standard Deviation	—	—	—
Mean	—	—	—
Sharpe Ratio	—	—	—

MPT Statistics	Standard Index	Best Fit Index
Alpha	—	—
Beta	—	—
R-Squared	—	—

12-Month Yield	—
30-day SEC Yield	—
Potential Cap Gains Exp	—

Investment Style
Equity
Stock %



Growth of $10,000
- Eaton Vance Paramtrc Struct Abs Ret I 10,070
- Category Average 10,051
- Standard Index 11,349

Performance Quartile (within category)

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	03-12	History
—	—	—	—	—	—	—	—	—	—	9.99	10.07	NAV/Price
—	—	—	—	—	—	—	—	—	—	—	0.80	Total Return %
—	—	—	—	—	—	—	—	—	—	—	-11.79	+/- Standard Index
—	—	—	—	—	—	—	—	—	—	—	0.64	+/- Category Index
—	—	—	—	—	—	—	—	—	—	—	—	% Rank Cat
—	—	—	—	—	—	—	—	—	—	—	120	No. of Funds in Cat

Portfolio Analysis

Asset Allocation %	Net %	Long %	Short %
Cash	—	—	—
US Stocks	—	—	—
Non-US Stocks	—	—	—
Bonds	—	—	—
Other/Not Clsfd	—	—	—
Total	—	—	—

Share Chg since	Share Amount	Holdings: 0 Total Stocks , 0 Total Fixed-Income, — Turnover Ratio	% Net Assets
—			

Equity Style

Value Blend Growth / Large Mid Small

Portfolio Statistics	Port Avg	Rel Index	Rel Cat
P/E Ratio TTM	—	—	—
P/C Ratio TTM	—	—	—
P/B Ratio TTM	—	—	—
Geo Avg Mkt Cap $mil	—	—	—

Fixed-Income Style

Ltd Mod Ext / High Med Low

Avg Eff Maturity	—
Avg Eff Duration	—
Avg Wtd Coupon	—
Avg Wtd Price	—

Credit Quality Breakdown —	Bond %
AAA	—
AA	—
A	—
BBB	—
BB	—
B	—
Below B	—
NR/NA	—

Regional Exposure	Stock %	Rel Std Index
Americas	—	—
Greater Europe	—	—
Greater Asia	—	—

Sector Weightings	Stocks %	Rel Std Index
Cyclical	—	—
Basic Materials	—	—
Consumer Cyclical	—	—
Financial Services	—	—
Real Estate	—	—
Sensitive	—	—
Communication Services	—	—
Energy	—	—
Industrials	—	—
Technology	—	—
Defensive	—	—
Consumer Defensive	—	—
Healthcare	—	—
Utilities	—	—

Operations

Family:	Eaton Vance	Base Currency:	USD	Incept:	10-31-2011
Manager:	Multiple	Ticker:	EPRIX	Type:	MF
Tenure:	0.5 Year	Minimum Initial Purchase:	$250,000	Total Assets:	$10.71 mil
Objective:	Growth	Purchase Constraints:	—		

Fund Reports

Palmer Square Absolute Return

by **Terry Tian**

Advisor
Palmer Square Capital Management LLC

Advisor Location
Leawood, Kansas

Assets Under Management
$126.3 million (fund)

Inception Date
May 17, 2011

Investment Type
Mutual fund

Morningstar Category
Multialternative

Management
The fund is comanaged by Christopher and Angie Long. Christopher Long, president of Palmer Square Capital Management, is primarily responsible for due diligence and manager sourcing. Prior to Palmer Square, he was a managing director at Prairie Capital, a registered investment advisor, where he was responsible for its funds of funds business. Christopher Long also served as a research analyst at Sandell Asset Management, a hedge fund firm, where he supported the firm's long-short credit and equity investments. Angie Long is charged with portfolio construction and risk management of the fund. She has 13 years of experience in derivatives trading and risk management at J.P. Morgan. The comanagers are supported by four investment analysts and one operational analyst.

Strategy
This multimanager fund aims to provide exposure to a variety of liquid hedge fund strategies, such as long-short equity, global macro, event-driven, and convertible arbitrage, while emphasizing downside protection. The strategy currently allocates among 10 hedge fund managers, who advise separately managed accounts with daily liquidity. As of March 1, sizable allocations by strategy included long-short credit (31%), long-short equity (30%), and global macro (25%). Management employs a core-satellite approach to allocate among subadvisors. First, the core holdings target low-volatility and low-market-exposure strategies (currently long-short and event-driven credit, and global macro and long-short equity). Second, the satellite bucket includes a set of strategies that have relatively higher market exposures and expected returns. The fund invests in six satellite managers (such as long-short equity, event-driven, currency, and convertible-bond arbitrage) as of March 1. Management may also engage in tactical allocation. For example, as of March 1, the fund allocated to an international long-short equity manager and a short-duration high-yield bond manager. Subadvisor turnover is expected to be low. Management might change one to three subadvisors in a time frame of two years, based on new access to better managers or performance/organizational red flags of existing managers. In the tactical-allocation sleeve, the comanagers might add or remove subadvisors according to their judgment of market opportunities. The strategy targets an annualized beta between 0.1 and 0.25 to the S&P 500 Index and a 5%–7% annualized standard deviation.

Process
The comanagers employ a top-down approach to portfolio construction. Management first allocates among the core, satellite, and tactical buckets. The core and satellite buckets receive roughly a 40% weight each, while the tactical bucket is allocated approximately 20% of the portfolio. Management can over- or underweight each bucket by approximately 10 percentage points based on its perceived investment opportunities. In selecting underlying hedge fund managers, the Longs emphasize: performance consistency; robust risk management (especially downside protection records during periods of broad market declines); low or no leverage; low beta and correlation to traditional assets and to other managers in the portfolio; strategy liquidity; and the subadvisors' personal financial commitments. Management then optimizes the portfolio to achieve the fund's beta and volatility targets, using the subadvisors' historical performance data, as well as forward-looking scenario tests and market simulations.

Risk Management
The fund's risk management consists of three components. First, comanager Angie Long controls operational risk by emphasizing key areas of due diligence (such as manager and company background checks, strategy transparency, and service providers). Second, management monitors daily risk reports, which detail the fund's aggregated long and short exposures by geography, industry, and investment theme (such as oil-price risk and emerging-markets risk), as well as position overlaps and beta/volatility readings. Angie Long also stress-tests the portfolio under various adverse market scenarios. Third, management employs portfolio level hedges to prevent the fund from deviating from its beta and volatility targets. The instruments used in this fund level hedge are all index-based derivatives, such as equity and credit index options.

Release date 03-31-2012

Palmer Square Absolute Return A (USD)

Standard Index	Category Index	Morningstar Cat
S&P 500 TR	BarCap US Agg Bond TR USD	US OE Multialternative

Performance 03-31-2012

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2010	—	—	—	—	—
2011	—	—	-5.11	0.32	—
2012	2.00	—	—	—	2.00

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	—	—	—	—	-8.58
Std 03-31-2012	—	—	—	—	-8.58
Total Return	—	—	—	—	-3.00
+/- Std Index	—	—	—	—	—
+/- Cat Index	—	—	—	—	—
% Rank Cat	—	—	—	—	
No. in Cat	—	—	—	—	
7-day Yield	—				

Performance Disclosure

The Overall Morningstar Rating is based on risk-adjusted returns, derived from a weighted average of the three-, five-, and 10-year (if applicable) Morningstar metrics.

The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate; thus an investor's shares, when sold or redeemed, may be worth more or less than their original cost.

Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please call 866-933-9033 or visit www.palmersquarecap.com.

Fees and Expenses

Sales Charges

Front-End Load %	**5.75**
Deferred Load %	**NA**

Fund Expenses

Management Fees %	1.95
12b1 Expense %	0.25
Gross Expense Ratio %	**3.06**
Prospectus Gross Expense Ratio %	**3.06**

Risk and Return Profile

	3 Yr	5 Yr	10 Yr
	—	—	—
Morningstar Rating™	—	—	—
Morningstar Risk	—	—	—
Morningstar Return	—	—	—

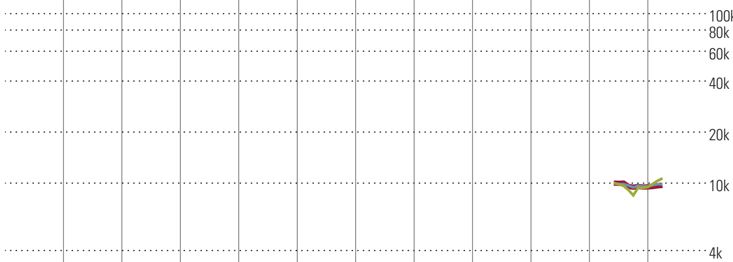
	3 Yr	5 Yr	10 Yr
Standard Deviation	—	—	—
Mean	—	—	—
Sharpe Ratio	—	—	—

MPT Statistics	Standard Index	Best Fit Index
Alpha	—	—
Beta	—	—
R-Squared	—	—

12-Month Yield	—
30-day SEC Yield	—
Potential Cap Gains Exp	—

Investment Style
Fixed-Income
Bond %

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	03-12
—	—	—	—	—	—	—	—	—	—	48	—



Growth of $10,000
- Palmer Square Absolute Return A 9,681
- Category Average 9,821
- Standard Index 10,662

Performance Quartile (within category)

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	03-12	History
—	—	—	—	—	—	—	—	—	—	9.51	9.70	NAV/Price
—	—	—	—	—	—	—	—	—	—	—	2.00	Total Return %
—	—	—	—	—	—	—	—	—	—	—	-10.59	+/- Standard Index
—	—	—	—	—	—	—	—	—	—	—	1.70	+/- Category Index
—	—	—	—	—	—	—	—	—	—	—	—	% Rank Cat
—	—	—	—	—	—	—	—	—	—	—	235	No. of Funds in Cat

Portfolio Analysis 10-31-2011

Asset Allocation %	Net %	Long %	Short %
Cash	64.34	82.18	17.84
US Stocks	7.40	19.62	12.22
Non-US Stocks	3.00	4.30	1.29
Bonds	17.31	107.79	90.48
Other/Not Clsfd	7.94	9.82	1.88
Total	100.00	223.71	123.71

Equity Style: Value Blend Growth / Large Mid Small

Portfolio Statistics	Port Avg	Rel Index	Rel Cat
P/E Ratio TTM	14.6	0.98	0.93
P/C Ratio TTM	8.8	0.97	0.97
P/B Ratio TTM	2.1	0.95	1.01
Geo Avg Mkt Cap $mil	14691	0.28	0.69

Fixed-Income Style: Ltd Mod Ext / High Med Low

Avg Eff Maturity	—
Avg Eff Duration	—
Avg Wtd Coupon	8.00
Avg Wtd Price	95.77

Credit Quality Breakdown —	Bond %
AAA	—
AA	—
A	—
BBB	—
BB	—
B	—
Below B	—
NR/NA	—

Regional Exposure	Stock %	Rel Std Index
Americas	83.6	0.84
Greater Europe	10.6	105.02
Greater Asia	5.8	—

Share Chg since 07-2011	Share Amount	Holdings: 2,726 Total Stocks , 174 Total Fixed-Income, — Turnover Ratio	% Net Assets
☼	10 mil	Cdx Na Hy 16 Liab 06/20/2016	-11.51
☼	10 mil	Cdx Na Hy 16 Asset 06/20/2016	11.13
⊕	55,500	SPDR S&P 500	8.01
☼	500 mil	Jpy 5/31/16 Irsasset (8)	7.37
☼	500 mil	Jpy 5/31/16 Irs Liab (8)	-7.36
⊕	6 mil	Australia Cds Asset 09/20/2016	-7.03
☼	6 mil	Australia Cds Asset 12/20/2016	-6.97
⊕	6 mil	Australia Cds Liab 09/20/2016	6.91
☼	6 mil	Australia Cds Liab 12/20/2016	6.85
☼	360 mil	Jpy 5/31/16 Irs Liab (9)	-5.30
☼	360 mil	Jpy 5/31/16 Irsasset (9)	5.30
⊕	35,316	SPDR S&P 500	-5.10
⊕	4 mil	Korea Cds Liability 09/20/2016	4.35
⊕	4 mil	Korea Cds Asset 09/20/2016	-4.28
☼	3 mil	Germany Cds Liab 12/20/2016	4.01

Sector Weightings	Stocks %	Rel Std Index
Cyclical	**33.9**	**1.23**
Basic Materials	4.0	1.24
Consumer Cyclical	17.9	1.89
Financial Services	9.3	0.71
Real Estate	2.6	1.46
Sensitive	**47.7**	**1.03**
Communication Services	5.8	1.41
Energy	6.0	0.50
Industrials	20.0	1.71
Technology	15.9	0.85
Defensive	**18.4**	**0.71**
Consumer Defensive	7.4	0.65
Healthcare	9.8	0.88
Utilities	1.3	0.38

Operations

Family:	Palmer Square Capital Management LLC	Ticker:	PSQAX	Incept:	05-17-2011
Manager:	Multiple	Minimum Initial Purchase:	$2,500	Type:	MF
Tenure:	0.9 Year	Min Auto Investment Plan:	$2,500	Total Assets:	$126.27 mil
Objective:	Growth	Minimum IRA Purchase:	$2,500		
Base Currency:	USD	Purchase Constraints:	—		

MORNINGSTAR®

Fund Reports

William Blair Macro Allocation

by **Mallory Horejs**

Advisor
William Blair & Company LLC

Advisor Location
Chicago, Illinois

Assets Under Management
$9.7 million

Inception Date
Nov. 29, 2011

Investment Type
Mutual fund

Morningstar Category
Multialternative

Management
Brian Singer, Edwin Denson, and Thomas Clarke run this fund. The team has worked together for more than 11 years, beginning at Brinson Partners (now UBS) and then at Singer Partners, a global macro hedge fund launched by Brian Singer in 2009. Prior to that, Singer headed up global investment solutions for UBS Global Asset Management. In June 2011, William Blair acquired Singer Partners, bringing distribution and market resources to this global macro strategy. Singer, Denson, and Clark have applied the same investment process and macro-oriented philosophy across all of these experiences. They also manage a hedge fund according to the same mandate, but with more volatility.

Strategy

This global asset-allocation fund seeks to profit from the price dislocations across equities, fixed income, and currencies worldwide. Singer and his team look for market segments and currencies trading below their fundamental value and seek to profit as these assets converge to their fundamental value over time. The team analyzes and invests across roughly 60 equity and fixed-income countries or sectors and 30 currencies, using exchange-traded funds, futures contracts, and swaps. The portfolio does not hold individual company securities. The strategy maintains a long-term focus, roughly five to eight years, because it can take a while for prices to converge to fundamental values.

The fund's stated return benchmark is three-month U.S. Treasuries, but management believes the fund can be measured against a 30% MSCI World, 40% Barclays Aggregate Bond Index, and 30% BoA/ML Three-Month U.S Treasury Bill Index over time. Management targets the volatility of a balanced portfolio.

Process

Management follows a three-step investment process. First, it looks for price/value discrepancies across different asset classes. Singer and his team use discounted cash flow models to determine fundamental values of various market indexes. Next, management seeks to understand the macro themes causing prices to differ from fundamental value by evaluating economic conditions, monetary policy, and investor behavior. Examples of these themes include inflation protection and fear-driven mispricing. The time horizon for this part of the analysis is shorter-term, roughly three to five years. Singer believes that investor behavior primarily drives price/value discrepancies, so most of the team's time is spent in this phase. Lastly, management constructs the portfolio according to its top-down point of view within its notional risk exposure guidelines. When management is bullish (bearish) and price/value discrepancies are wide (narrow), the fund will typically have a large positive (negative) equity exposure and negative (positive) currency and fixed-income exposures. Currency exposures are determined independently of the fund's equity and fixed-income exposures.

As of Dec. 31, 2011, broad asset-class allocations (net notional exposure as a percentage of assets) were as follows: 74.8% global equity, negative 14.6% global fixed income, and 39.7% cash. The largest long exposures were to European ex-U.K. equities (26.2%), U.S. large-cap value equities (19.1%), and U.S. mortgage-backed securities (16.0%). All significant short positions were on the fixed-income side: 10-year Swiss bonds (negative 20.2%) and 10-year U.S. Treasuries (negative 17.0%). In terms of currency exposure, the fund was largely long the U.S. dollar (88.5%) and Asian (ex-Japan) currencies (40.2%) but short the Swiss Franc (negative 17.7%).

Risk Management

The exposure ranges for each asset class are based upon historical performance as well as management's total risk budget of 9%–10% annualized. The portfolio's aggregate allocation to global equity will range from negative 20% to 80%, while global fixed income can range from negative 50% to 130% of total portfolio assets, and U.S. dollar exposure can range from negative 60% to 150%. The fund's equity market beta is expected to be about 0.3 on average.

Release date 03-31-2012

William Blair Macro Allocation I (USD)

Standard Index	Category Index	Morningstar Cat
S&P 500 TR	BarCap US Agg Bond TR USD	US OE Multialternative

Performance 03-31-2012

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2010	—	—	—	—	—
2011	—	—	—	—	—
2012	10.79	—	—	—	10.79

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	—	—	—	—	13.71
Std 03-31-2012	—	—	—	—	13.71
Total Return	—	—	—	—	13.71
+/- Std Index	—	—	—	—	—
+/- Cat Index	—	—	—	—	—
% Rank Cat	—	—	—	—	
No. in Cat	—	—	—	—	
7-day Yield	—				

Performance Disclosure

The Overall Morningstar Rating is based on risk-adjusted returns, derived from a weighted average of the three-, five-, and 10-year (if applicable) Morningstar metrics.

The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate; thus an investor's shares, when sold or redeemed, may be worth more or less than their original cost.

Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please call 800-742-7272 or visit www.wmblair.com.

Fees and Expenses

Sales Charges

Front-End Load %	**NA**
Deferred Load %	**NA**

Fund Expenses

Management Fees %	0.80
12b1 Expense %	NA
Gross Expense Ratio %	**1.54**
Prospectus Gross Expense Ratio %	**1.54**

Risk and Return Profile

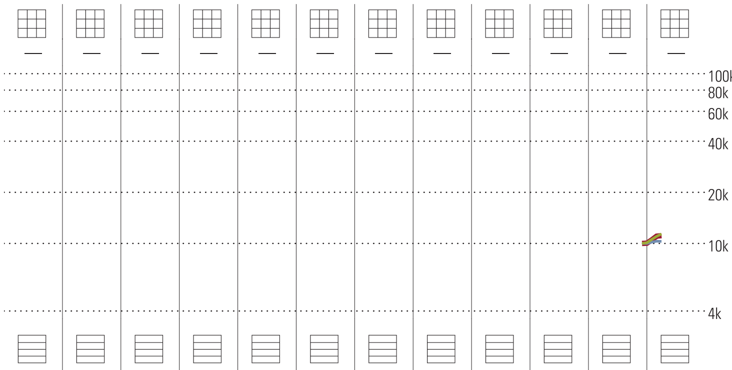
	3 Yr	5 Yr	10 Yr
	—	—	—
Morningstar Rating™	—	—	—
Morningstar Risk	—	—	—
Morningstar Return	—	—	—

	3 Yr	5 Yr	10 Yr
Standard Deviation	—	—	—
Mean	—	—	—
Sharpe Ratio	—	—	—

MPT Statistics	Standard Index	Best Fit Index
Alpha	—	—
Beta	—	—
R-Squared	—	—

12-Month Yield	—
30-day SEC Yield	—
Potential Cap Gains Exp	—

Investment Style
Equity
Stock %



Growth of $10,000

- William Blair Macro Allocation I 11,115
- Category Average 10,279
- Standard Index 11,374

Performance Quartile (within category)

History	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	03-12
NAV/Price	—	—	—	—	—	—	—	—	—	—	10.19	11.29
Total Return %	—	—	—	—	—	—	—	—	—	—	—	10.79
+/- Standard Index	—	—	—	—	—	—	—	—	—	—	—	-1.79
+/- Category Index	—	—	—	—	—	—	—	—	—	—	—	10.49
% Rank Cat	—	—	—	—	—	—	—	—	—	—	—	—
No. of Funds in Cat	—	—	—	—	—	—	—	—	—	—	—	235

Portfolio Analysis

Asset Allocation %	Net %	Long %	Short %
Cash	—	—	—
US Stocks	—	—	—
Non-US Stocks	—	—	—
Bonds	—	—	—
Other/Not Clsfd	—	—	—
Total	—	—	—

Share Chg since	Share Amount	Holdings:	% Net Assets
—		0 Total Stocks , 0 Total Fixed-Income, — Turnover Ratio	

Equity Style

Value Blend Growth
Large Mid Small

Portfolio Statistics	Port Avg	Rel Index	Rel Cat
P/E Ratio TTM	—	—	—
P/C Ratio TTM	—	—	—
P/B Ratio TTM	—	—	—
Geo Avg Mkt Cap $mil	—	—	—

Fixed-Income Style

Ltd Mod Ext
High Med Low

Avg Eff Maturity	—
Avg Eff Duration	—
Avg Wtd Coupon	—
Avg Wtd Price	—

Credit Quality Breakdown —	Bond %
AAA	—
AA	—
A	—
BBB	—
BB	—
B	—
Below B	—
NR/NA	—

Regional Exposure	Stock %	Rel Std Index
Americas	—	—
Greater Europe	—	—
Greater Asia	—	—

Sector Weightings	Stocks %	Rel Std Index
Cyclical	—	—
Basic Materials	—	—
Consumer Cyclical	—	—
Financial Services	—	—
Real Estate	—	—
Sensitive	—	—
Communication Services	—	—
Energy	—	—
Industrials	—	—
Technology	—	—
Defensive	—	—
Consumer Defensive	—	—
Healthcare	—	—
Utilities	—	—

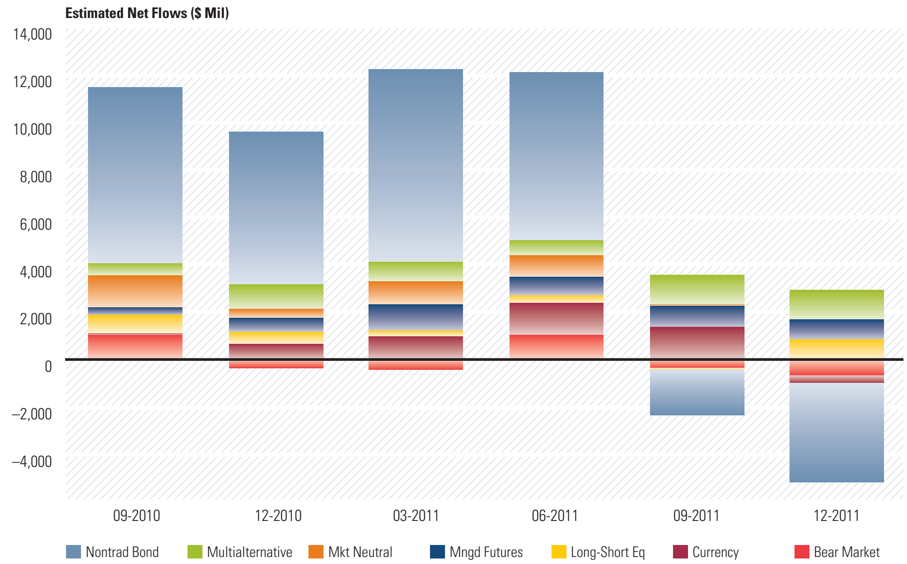
Operations

Family:	William Blair & Company LLC	Base Currency:	USD	Incept:	11-29-2011
Manager:	Multiple	Ticker:	WMCIX	Type:	MF
Tenure:	0.4 Year	Minimum Initial Purchase:	$0	Total Assets:	$9.70 mil
Objective:	Asset Allocation	Purchase Constraints:	—		

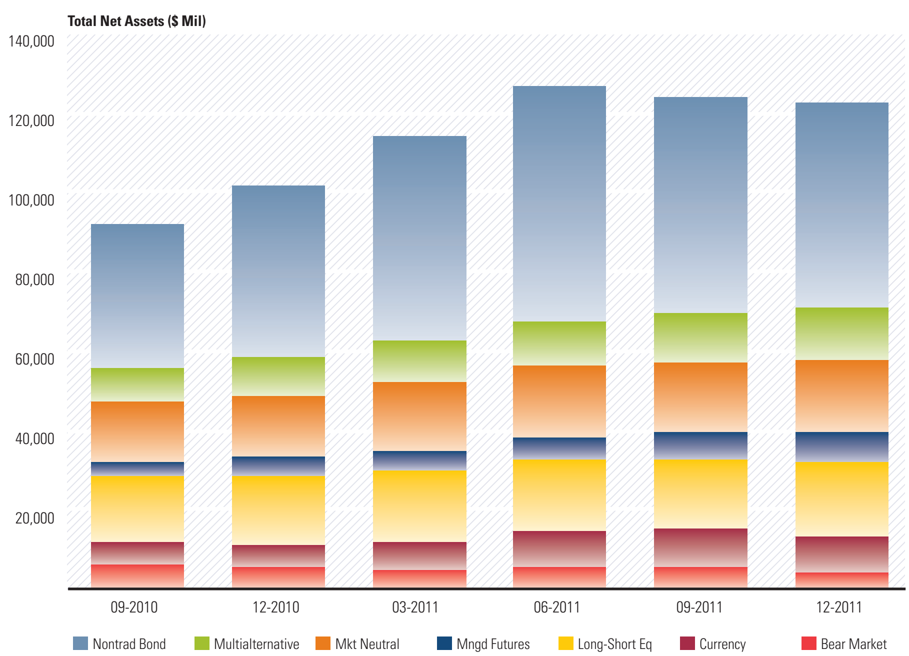
Flows and Assets Under Management: Alternative Mutual Funds

Quarterly Alternative Mutual Fund Flows
During the fourth quarter of 2011, alternative mutual funds experienced net outflows of more than $2.2 billion, a significant turnaround from the $1.2 billion of inflows seen in the third quarter. The outflows came primarily from funds in the non-traditional-bond category, which bled $4.2 billion in the fourth quarter after losing almost $2 billion in the third quarter. Two other alternative mutual fund categories, bear-market equity and currency, exhibited smaller net outflows during the fourth quarter of $673 million and $316 million, respectively. Funds in the multialternative, long-short equity, and managed-futures categories saw substantial net inflows of $1.2 billion, $885 million, and $806 million, respectively.

Morningstar launched the non-traditional-bond category on Oct. 31, 2011. This category encompasses funds that hedge or bet against duration and/or credit risk. The category addition resulted in significant retroactive changes to alternative fund flow data.



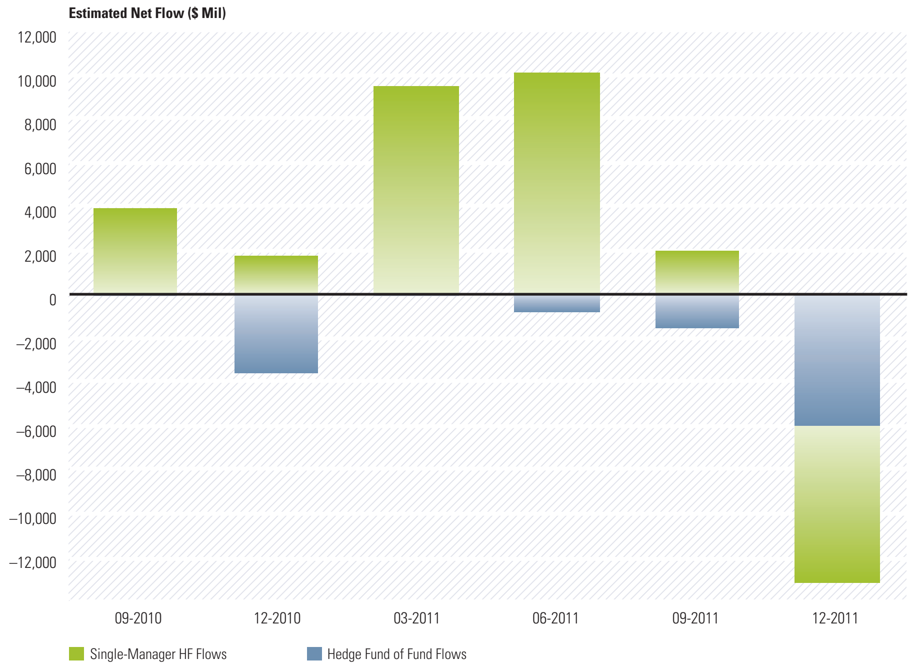
Quarterly Alternative Mutual Fund Assets Under Management
Assets under management of all alternative mutual funds fell by 1.6% during the fourth quarter of 2011 to $122.3 billion. Four of the seven alternative mutual fund categories gained assets during the fourth quarter, however. Multialternative and managed-futures funds experienced the most significant gains in assets (10.2% and 9.1%, respectively) primarily because of inflows. Bear-market equity funds saw the largest percentage drop in assets during the fourth quarter (23.9%), and total assets in this category remain the lowest of all the alternative mutual fund categories at $4.5 billion as of Dec. 31, 2011. The largest alternative mutual fund category, nontraditional bond, leaked 6.5% of its total assets quarter-over-quarter.



Flows and Assets Under Management: Hedge Funds

Quarterly Hedge Fund Flows

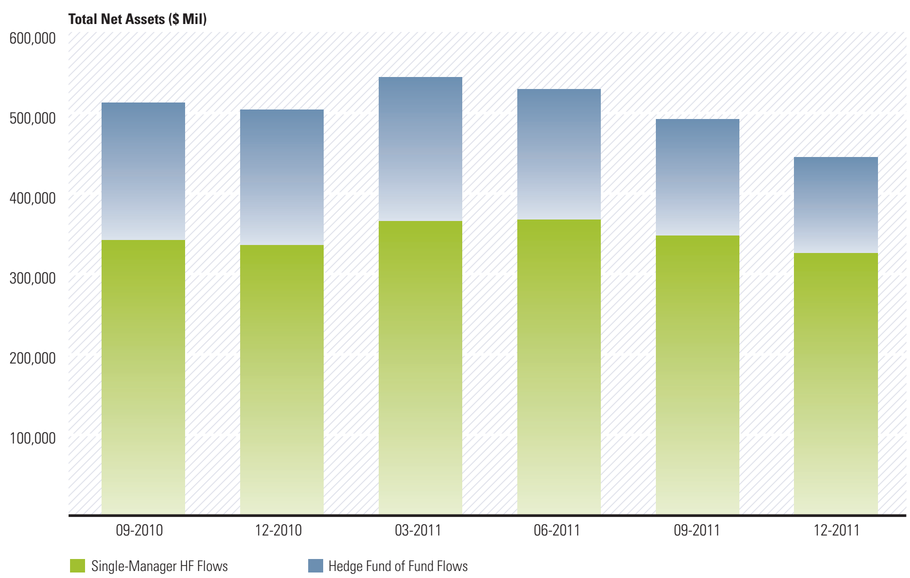
During the fourth quarter of 2011, single-manager hedge funds in Morningstar's database experienced outflows of $7 billion, and hedge funds of funds in Morningstar's database saw outflows of $6 billion. Despite fourth-quarter outflows, single-manager hedge funds in the database raked in almost $14.5 billion throughout 2011. Global macro and event-driven hedge funds in the database bled more than any other category during the fourth quarter, suffering outflows of $3.6 billion and $1.4 billion, respectively. The majority of the global macro outflows can be attributed to a few funds with very large asset bases. Diversified arbitrage and systematic futures funds experienced the largest inflows: $523.7 million and $390.2 million, respectively.



Quarterly Hedge Fund Assets Under Management

Single-manager hedge fund assets under management in Morningstar's database decreased 6.9% during the fourth quarter. For the 2011 year (as of Dec. 31, 2011), assets under management of single-manager hedge funds fell by 4.7%, primarily because of poor performance. As of year-end, hedge funds of funds in Morningstar's database manage 14.2% less than in the prior quarter and are down 22.4% from a year ago.

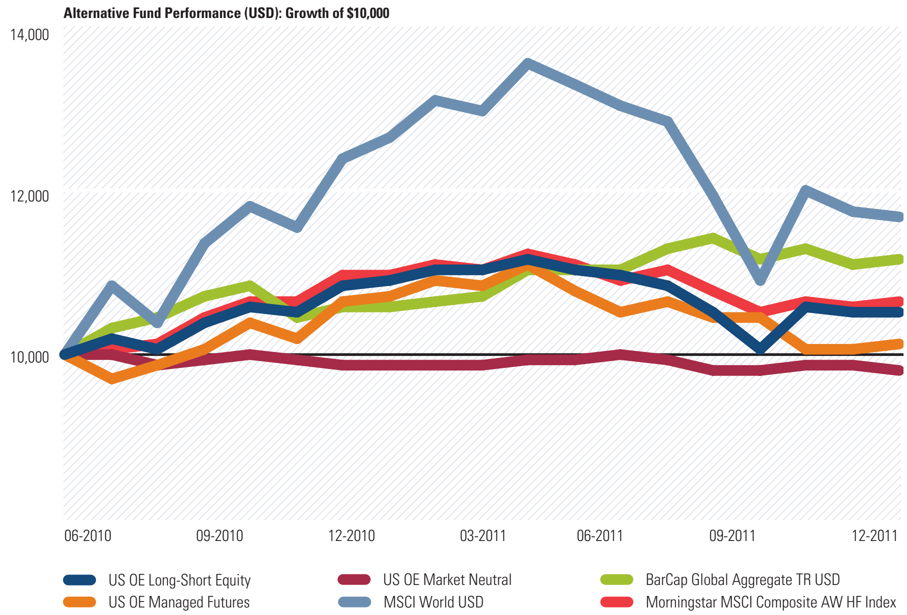
Morningstar does not report total hedge fund industry flows or assets, as these figures are based on estimates and projections of voluntarily reported information.



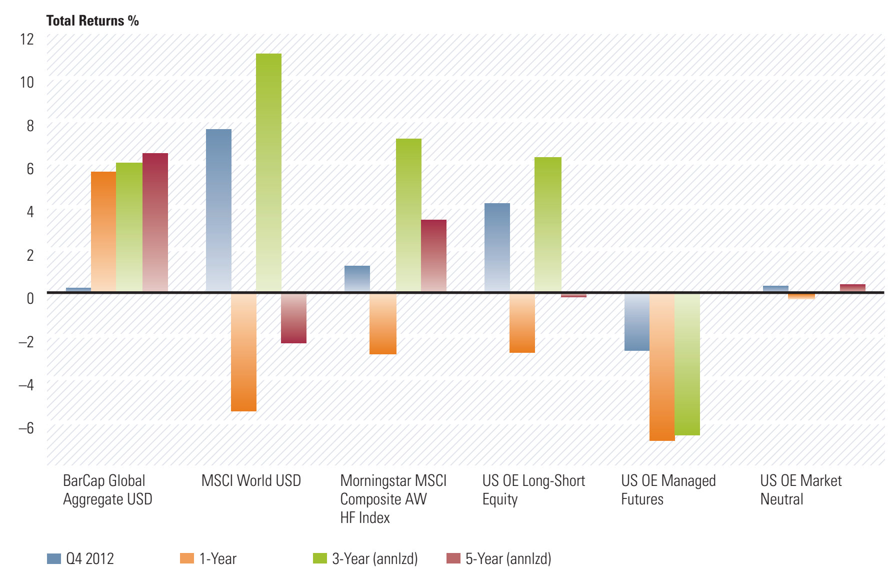
Alternative Investment Performance

Growth of a $10,000 Alternative Investment
Hedge funds, as proxied by the Morningstar MSCI Composite AW Hedge Fund Index, gained 1.3% in the fourth quarter, while global stocks, as represented by the MSCI World NR Index, posted 7.6% gains. The MSCI World NR Index gained 17.1% over the 18 months ended Dec. 31, while the Morningstar MSCI Composite AW Hedge Fund Index lagged over the same period with a 6.4% increase. Although long-short equity mutual funds outperformed the average hedge fund during the fourth quarter, hedge funds in Morningstar's database have outpaced alternative mutual funds over the past 18 months.

Morningstar no longer publishes its proprietary hedge fund indexes. As proxies for the indexes, Morningstar uses the Morningstar MSCI series of indexes, including the Morningstar MSCI Composite AW, a currency-hedged asset-weighted index with 941 hedge funds, and the applicable category averages.



Performance of Alternative Investments Over Time
Global stocks, as represented by the MSCI World NR Index, significantly outperformed the average hedge fund (per the Morningstar MSCI Composite AW Hedge Fund Index) in the quarter ended Dec. 31, 2011. Hedge funds have provided better returns than equities over the past one and five years, but on an annualized three-year basis, equities have outperformed. Global bonds have fared better than both stocks and hedge funds have over the past one and five years. Alternative mutual funds (as represented by the long-short equity, managed-futures, and market-neutral category averages) underperformed hedge funds over the three-year period ended Dec. 31, 2011. Over a one-year period, market-neutral mutual funds did a better job of mitigating losses.

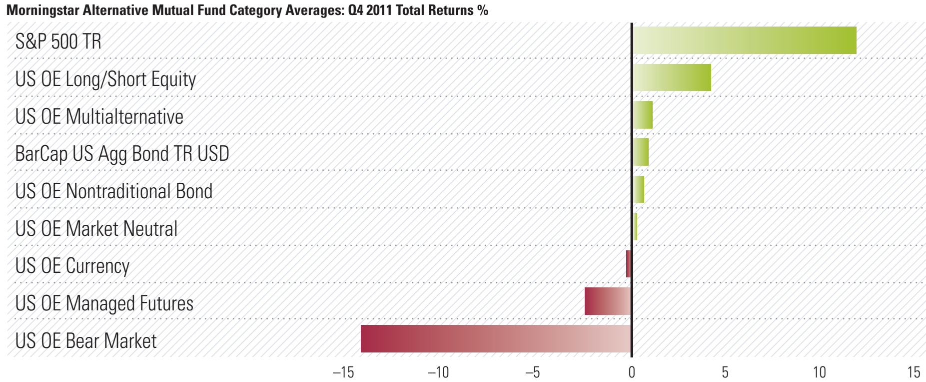


Q3 Performance by Category

Alternative Mutual Funds

The average managed-futures mutual fund lost 2.7% in the fourth quarter of 2011 because of sharp reversals in price trends in many futures contracts. The average bear-market fund plunged 14.5%, in sharp contrast to the S&P 500's 11.8% advance. Long-short equity mutual funds underperformed the broad stock market but still posted 4.2% returns. Currency mutual funds were relatively flat on average for the quarter ended Dec. 31, 2011, as the U.S. dollar depreciation in October was reversed in November and December.

Morningstar Alternative Mutual Fund Category Averages: Q4 2011 Total Returns %

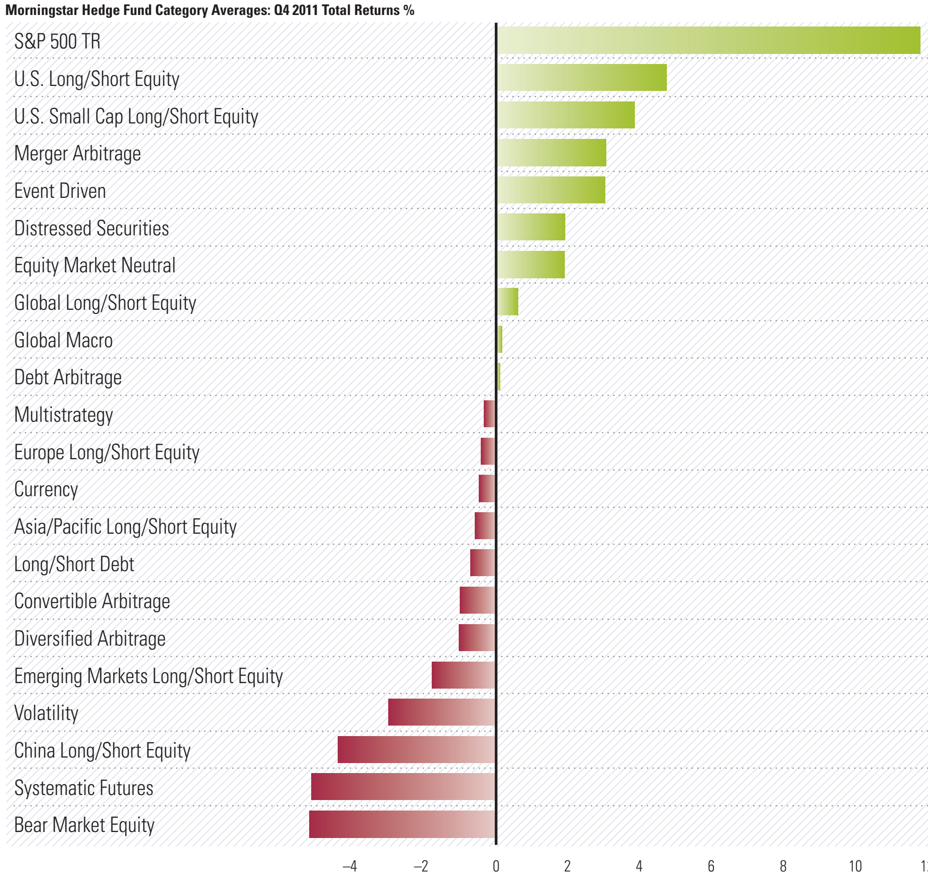


Hedge Funds

In the fourth quarter of 2011, there were both modest winners and losers among the hedge fund categories. The losers were funds in the bear-market equity and systematic futures categories, each of which lost approximately 5.2% on average. Funds in the U.S. long-short equity and U.S. small-cap long-short equity categories experienced the largest gains, averaging returns of 4.7% and 3.8%, respectively. Funds in Morningstar's event-driven and merger-arbitrage categories also posted modest gains of 3.0% each. The S&P 500 Index gained 11.8% during the quarter.

Morningstar is in the process of creating new indexes for its hedge fund categories.

Morningstar Hedge Fund Category Averages: Q4 2011 Total Returns %

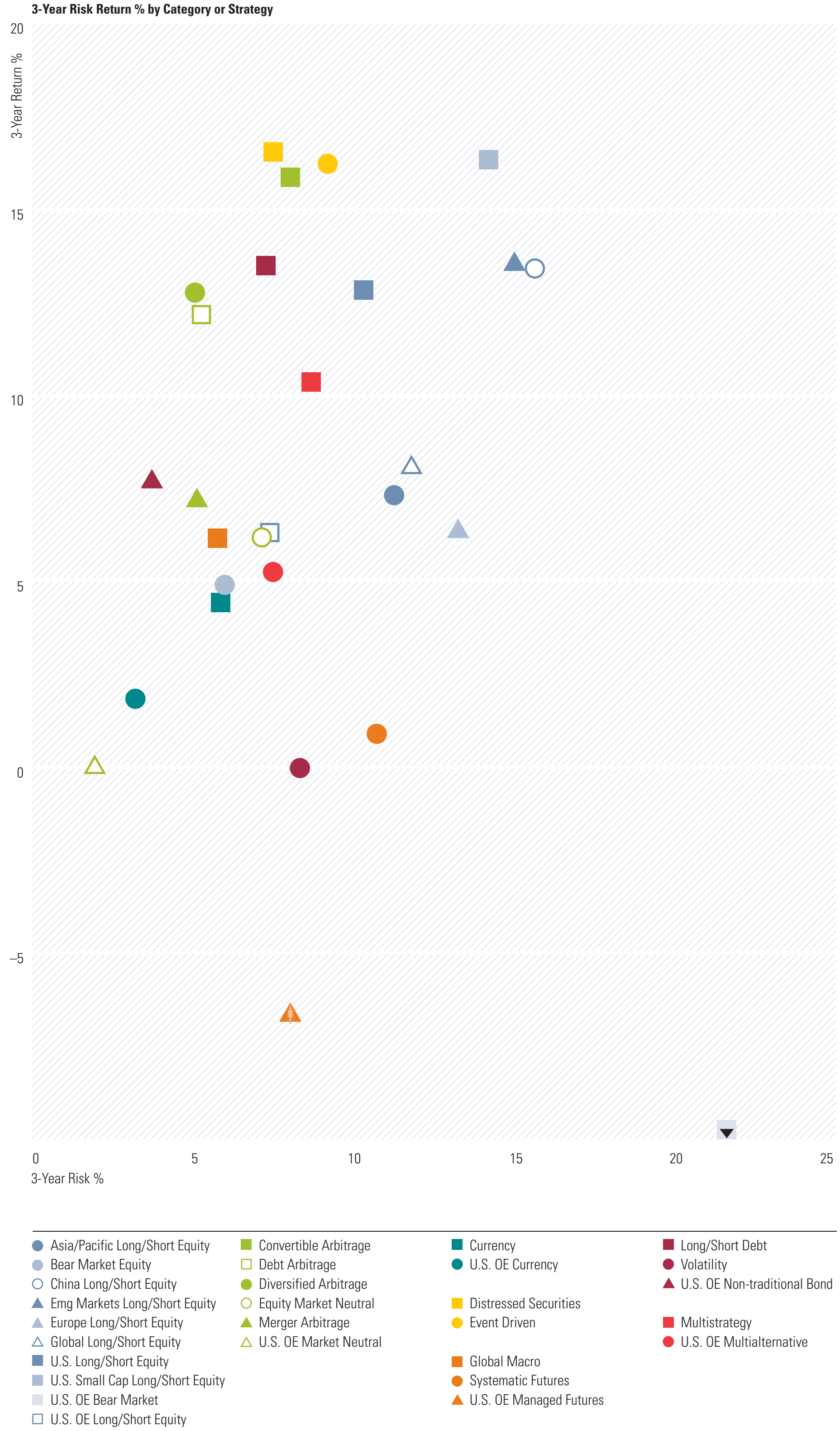


Risk Versus Return: Alternative Mutual Funds and Hedge Funds

Three-Year Standard Deviation and Return

Of the 28 alternative mutual fund and hedge fund category averages, 26 exhibited positive returns over the three years ended Dec. 31, 2011. Funds in the distressed securities, U.S. small-cap long-short equity and event-driven hedge fund categories showed the best three-year total returns on average of 16.6%, 16.3%, and 16.3%, respectively. In terms of risk-adjusted returns, however, diversified arbitrage and debt arbitrage hedge funds averaged the best results over the past three years. In contrast, funds in the U.S. bear-market mutual fund category saw a 26.8% annualized decline on average in the three-year period ended December 2011, while also exhibiting the highest standard deviation of all alternative mutual fund and hedge fund categories (22.7% annualized). The average managed-futures mutual fund also exhibited a poor three-year risk-adjusted return profile as well, losing 6.6% with an 8.0% annualized standard deviation.

3-Year Risk Return % by Category or Strategy



Correlations by Alternative Fund Strategy

Three–Year Correlations: Alternative Mutual Fund Categories	1	2	3	4	5	6	7
1 US OE Bear Market	1.00						
2 US OE Currency	–0.57	1.00					
3 US OE Long/Short Equity	–0.97	0.64	1.00				
4 US OE Managed Futures	–0.07	0.24	0.10	1.00			
5 US OE Market Neutral	–0.31	0.35	0.40	0.05	1.00		
6 US OE Multialternative	–0.94	0.53	0.91	0.19	0.23	1.00	
7 US OE Nontraditional Bond	–0.30	0.31	0.34	0.15	0.10	0.39	1.00

Three–Year Correlations: Hedge Fund Categories	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1 HF Asia/Pacific Long/Short Equity	1.00																				
2 HF Bear Market Equity	–0.14	1.00																			
3 HF China Long/Short Equity	0.31	–0.28	1.00																		
4 HF Convertible Arbitrage	0.75	–0.14	0.51	1.00																	
5 HF Currency	0.62	–0.01	0.25	0.49	1.00																
6 HF Debt Arbitrage	0.80	–0.13	0.36	0.90	0.65	1.00															
7 HF Distressed Securities	0.81	–0.25	0.22	0.80	0.54	0.84	1.00														
8 HF Diversified Arbitrage	0.69	–0.11	0.48	0.82	0.39	0.76	0.63	1.00													
9 HF Emerging Markets Long/Short Equity	0.79	–0.26	0.71	0.81	0.56	0.78	0.72	0.68	1.00												
10 HF Equity Market Neutral	0.85	–0.10	0.37	0.76	0.65	0.87	0.73	0.67	0.80	1.00											
11 HF Europe Long/Short Equity	0.88	–0.12	0.30	0.79	0.75	0.89	0.78	0.69	0.78	0.94	1.00										
12 HF Event Driven	0.88	–0.29	0.43	0.89	0.58	0.86	0.89	0.75	0.87	0.86	0.88	1.00									
13 HF Global Long/Short Equity	0.92	–0.19	0.40	0.82	0.68	0.88	0.83	0.71	0.85	0.94	0.96	0.94	1.00								
14 HF Global Macro	0.75	0.09	0.32	0.62	0.87	0.76	0.61	0.49	0.66	0.84	0.83	0.70	0.81	1.00							
15 HF Long/Short Debt	0.86	–0.06	0.35	0.88	0.69	0.95	0.82	0.74	0.81	0.90	0.92	0.88	0.90	0.80	1.00						
16 HF Merger Arbitrage	0.83	–0.39	0.33	0.80	0.63	0.87	0.75	0.68	0.78	0.92	0.95	0.88	0.93	0.76	0.89	1.00					
17 HF Multistrategy	0.88	–0.09	0.42	0.86	0.72	0.92	0.80	0.73	0.83	0.95	0.96	0.91	0.97	0.86	0.93	0.91	1.00				
18 HF Systematic Futures	0.59	0.23	0.22	0.43	0.79	0.57	0.49	0.32	0.45	0.61	0.64	0.50	0.64	0.87	0.60	0.52	0.70	1.00			
19 HF U.S. Long/Short Equity	0.88	–0.33	0.43	0.83	0.53	0.81	0.87	0.69	0.85	0.85	0.85	0.97	0.94	0.68	0.82	0.85	0.88	0.50	1.00		
20 HF U.S. Small Cap Long/Short Equity	0.89	–0.30	0.44	0.82	0.53	0.80	0.86	0.66	0.86	0.84	0.84	0.96	0.93	0.70	0.81	0.84	0.88	0.54	0.98	1.00	
21 HF Volatility	0.09	0.13	0.05	0.14	0.20	0.26	–0.02	0.15	0.05	0.31	0.24	0.03	0.18	0.39	0.31	0.24	0.27	0.43	0.01	0.08	1.00

1.00 to 0.76 | 0.75 to 0.51 | 0.50 to 0.25 | 0.25 to 0.00
0.00 to –0.24 | –0.25 to –0.49 | –0.50 to –0.74 | –0.75 to –1.00

Correlations of Alternative Funds to Traditional Asset Classes

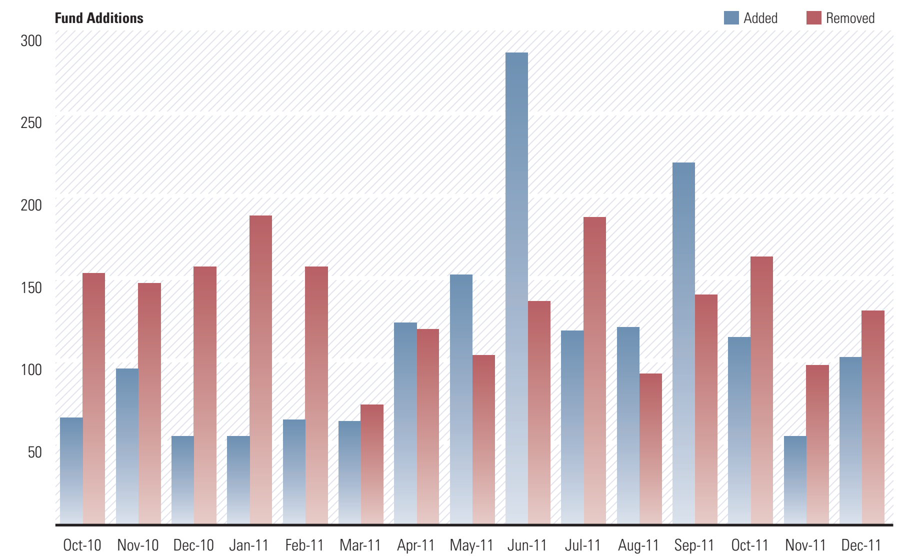
Correlation of Mutual Funds to U.S. Stocks and Bonds	S&P 500 Correlation (USD)			BarCap US Agg Correlation (USD)		
	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
US OE Bear Market	–0.98	–0.97	–0.97	–0.02	–0.19	0.01
US OE Currency	0.60	0.50	0.18	–0.07	0.00	0.22
US OE Long/Short Equity	0.96	0.95	0.84	–0.08	0.10	0.06
US OE Managed Futures	0.11	N/A	N/A	–0.13	N/A	N/A
US OE Market Neutral	0.23	0.10	–0.20	0.00	0.04	0.17
US OE Multialternative	0.94	0.94	0.86	0.06	0.20	–0.06
US OE Nontraditional Bond	0.57	0.72	0.59	0.06	0.21	0.33

Correlation of Hedge Funds to U.S. Stocks and Bonds	S&P 500 Correlation (USD)			BarCap US Agg Correlation (USD)		
	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
Morningstar MSCI Composite AW	0.70	0.70	0.65	–0.12	0.07	0.02
HF Asia/Pacific Long/Short Equity	0.82	0.79	0.67	0.00	0.25	0.11
HF Bear Market Equity	–0.48	–0.50	–0.53	0.10	0.02	0.08
HF China Long/Short Equity	0.29	0.34	N/A	–0.11	0.01	N/A
HF Convertible Arbitrage	0.66	0.73	0.64	–0.02	0.33	0.22
HF Currency	0.53	0.40	0.23	0.12	0.16	0.22
HF Debt Arbitrage	0.72	0.76	0.63	0.08	0.29	0.24
HF Distressed Securities	0.76	0.80	0.72	–0.13	0.03	–0.03
HF Diversified Arbitrage	0.55	0.63	0.53	0.04	0.27	0.22
HF Emerging Markets Long/Short Equity	0.71	0.75	0.71	–0.01	0.14	0.07
HF Equity Market Neutral	0.79	0.73	0.59	0.03	0.21	0.19
HF Europe Long/Short Equity	0.84	0.80	0.72	0.00	0.18	0.11
HF Event Driven	0.84	0.85	0.78	–0.10	0.13	0.05
HF Global Long/Short Equity	0.88	0.84	0.75	–0.03	0.17	0.08
HF Global Macro	0.63	0.54	0.47	0.15	0.25	0.18
HF Long/Short Debt	0.75	0.76	0.64	0.18	0.36	0.31
HF Merger Arbitrage	0.85	0.82	0.75	0.04	0.31	0.19
HF Multistrategy	0.78	0.76	0.73	–0.01	0.19	0.09
HF Systematic Futures	0.45	0.12	0.03	0.12	0.03	0.16
HF U.S. Long/Short Equity	0.90	0.90	0.87	–0.18	0.03	–0.06
HF U.S. Small Cap Long/Short Equity	0.88	0.88	0.86	–0.17	0.03	–0.09
HF Volatility	0.13	0.29	0.14	0.26	0.48	0.32

Morningstar Hedge Fund Database Overview as of 12-31-2011

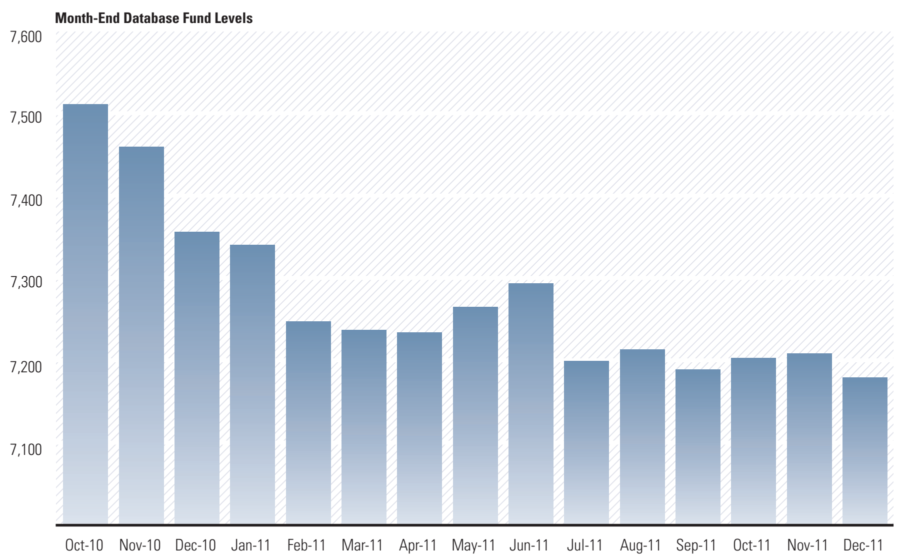
Net Fund Additions by Month

Morningstar's hedge fund database experienced net removals of 120 funds during the fourth quarter of 2011. The database saw 270 additions and 390 fund removals during the quarter. Funds drop out because they have liquidated or because they cease sharing performance data, typically because of poor performance. Fund additions occur as a result of new fund launches or a recent agreement to supply data to Morningstar.



Month-End Database Fund Levels

As of Dec. 31, 2011, the Morningstar hedge fund database contained 7,179 funds that actively report performance and assets-under-management data. This figure includes 4,510 single-manager hedge funds and 2,669 funds of hedge funds. As of quarter-end, the number of funds in the database had dropped approximately 4.4% from October 2010 levels.



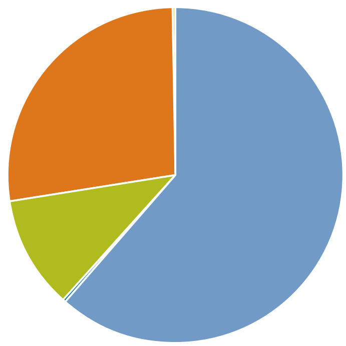
Morningstar Hedge Fund Database Overview as of 12-31-2011

Hedge Funds by Region

Approximately 61.4% of hedge funds in the Morningstar database are legally domiciled in the North American/Caribbean region, primarily in the United States and the Cayman Islands. A large percentage of U.K. hedge funds are also domiciled in the Cayman Islands for tax and regulatory purposes. Approximately 27.3% of funds in Morningstar's database are domiciled in Europe, including both European Union and non-EU jurisdictions, and 10.8% of funds are domiciled in Asia and Australia, primarily in China.

Morningstar now reports where hedge funds are legally domiciled, instead of the advisors' locations.

Morningstar Hedge Fund Database by Region



Region	# Funds
N. America/Carribean	4,429
Africa	30
Asia/Australia	779
Europe	1,968
South America	2
Other	0
Total	**7,208**

Hedge Funds by Location

Approximately 77.4% of the hedge funds in Morningstar's database are domiciled in the United States, the Cayman Islands, China, the British Virgin Islands, Bermuda, and Luxembourg. Both France and Ireland continue to domicile a large portion of European hedge funds, trailing Luxembourg.

North America and Surrounding	**4,429**
Cayman Islands	1907
United States	1356
British Virgin Islands	478
Bermuda	396
Canada	205
Curacao	48
Bahamas	28
Panama	6
St. Vincent & the Grenadines	3
Barbados	1
St. Kitts & Nevis	1

Africa	**30**
Mauritius	15
South Africa	14
Swaziland	1

Asia and Australia	**779**
China	730
Australia	35
Christmas Island	1
Hong Kong	7
Japan	2
Singapore	1
Bahrain	1
Marshall Islands	1
Vanuatu	1

Europe	**1,968**
Luxembourg	712
Ireland	180
France	207
Guernsey	139
Switzerland	130
Italy	108
Sweden	88
Malta	72
Jersey	71
Netherlands	61
Liechtenstein	59
United Kingdom	23
Spain	34
Finland	20
Isle of Man	9
Austria	10
Denmark	11
Germany	11
Channel Islands	9
Gibraltar	5
Cyprus	3
Norway	3
Belgium	1
Andorra	1
Greece	1

South America	**2**
Brazil	2

Morningstar Hedge Fund Database Overview as of 12-31-2011

Service Providers

Morgan Stanley and Goldman Sachs are the largest prime brokerage-service providers to hedge funds in Morningstar's database, serving a 31.2% share combined. The big four accounting firms are employed by approximately 75.6% of hedge funds listing auditors in the database, with PricewaterhouseCoopers leading the pack. Citco Fund Services provides administration services to 8.6% of funds in Morningstar's database, significantly more than the next-largest administrator. Maples and Calder, Dechert, and Seward & Kissel are the three largest legal-counsel-service providers to hedge funds in the database, with a combined 23.7% market share. Several China-domiciled prime brokers and administrators joined the top 10 service provider rankings in the fourth quarter, as the database acquired more Chinese hedge funds.

Type	Rank	Service Provider	% of Database
Prime Broker	1	Morgan Stanley	16.42
	2	Goldman Sachs	14.79
	3	UBS	8.39
	4	Deutsche Bank	7.39
	5	Credit Suisse	6.79
	6	J.P. Morgan	6.27
	7	Bank of America/Merrill Lynch	4.76
	8	Newedge	4.27
	9	Guosen Securities	3.7
	10	China International Capital Corp	3.18
Legal Counsel	1	Maples & Calder	10.46
	2	Dechert	6.69
	3	Seward & Kissel	6.51
	4	Elvinger, Hoss & Prussen	5.44
	5	Simmons & Simmons	4.72
	6	Walkers	4.33
	7	Schulte Roth & Zabel	3.72
	8	Sidley & Austin	3.23
	9	Appleby	3.18
	10	Ogier	2.82
Auditor	1	Pricewaterhouse Coopers	24.45
	2	KPMG	18.75
	3	Ernst & Young	18.42
	4	Deloitte	14.02
	5	Rothstein Kass	5.39
	6	RSM / McGladery & Pullen	2.74
	7	Grant Thornton	2.30
	8	BDO	2.09
	9	Eisner	1.06
	10	Arthur Bell	0.85
Administrator	1	Citco	8.64
	2	Citigroup	3.95
	3	HSBC	3.88
	4	Apex	2.75
	5	China Resources SZITIC Trust Co.	2.73
	6	CIBC / BNY Mellon	2.72
	7	Zhongrong International Trust Co.	2.67
	8	Northern Trust	2.57
	9	CACEIS Fastnet	2.28
	10	Pingan Trust Investment Co.	2.18

Alternative Investments Observer

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