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Alternative Investments Observer

MORNINGSTAR®

Shooting Beyond the Stars

The New Forward-Looking Morningstar Analyst Ratings for Alternative Mutual Funds.

by
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Morningstar has come a long way since the original Morningstar Rating™. Introduced in 1985, the 5-star rating system was designed to quantitatively rank funds on past risk-adjusted performance relative to their peers, on a three-, five-, and 10-year basis. While the Morningstar Ratings are still alive and well, and have shown to be somewhat predictive over time, they paint an incomplete picture for investors attempting to pick the future winners. What happens to a fund if a manager leaves or if the investment process changes, for example? It's clear that factors other than past performance matter.

With alternative investments, past performance is even less of a predictor. This is because many alternative strategies thrive in certain types of market environments but flounder in others. For example, long-short equity funds perform better when there is dispersion among stock returns—that is, there is an "alpha" to be had by selecting the best stocks and shorting the worst stocks. When investor sentiment causes most stocks to move up or down at the same time, as it has since 2008, these strategies underperform. Managed futures, as another example, do well when the prices in different futures markets are trending up or down for an extended period. This strategy had a bang-up year in 2008 but has treaded water since. Furthermore, funds in the same alternative category are not homogenous. Some long-short equity funds short stocks, while others simply hedge with exchange-traded funds, for example. Some managed-futures funds diversify across many asset classes, while others stick to just commodities. So how are investors supposed to make heads or tails of these alternative strategies and pick the best ones?

Obviously, no one has a crystal ball. Morningstar can't predict what market environment lies ahead any more than the next investor. But Morningstar believes there are factors that can determine whether a fund will outperform its peers over time. That's why, in November 2011, we launched forward-looking ratings on traditional mutual funds, and in June 2012, we launched forward-looking Morningstar Analyst Ratings on alternative mutual funds. By the end of 2012, we will have rated about 80 alternative funds, covering 85% of the alternative mutual fund assets.

Our forward-looking ratings analyze funds against their peers in five areas, or "pillars": **People, Parent, Process, Performance,** and **Price**. Each pillar is rated Negative, Neutral, or Positive. The goal is to find the funds in each category that will outperform relative to their category peers over the next three or more years. We use the same five pillars to rate alternative mutual funds and traditional funds alike, but alternative funds require a unique spin. Here's a deep dive into our alternatives rating methodology.

Power to the People

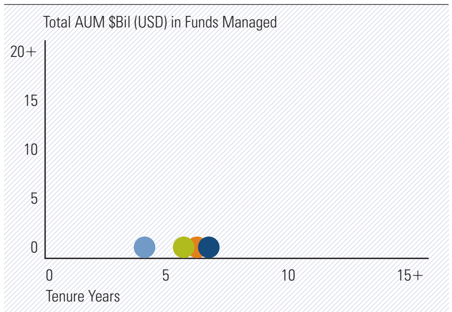
Our People pillar measures our confidence in a fund's management team. If the current manager has directed the fund and similar strategies for a long time, with success, we have more confidence in that manager going forward. The problem with alternative funds is that they are virtually brand new—almost 60% of the 340 distinct funds in Morningstar's seven alternative categories were launched after 2008. So it's hard to have confidence in those managers—at least regarding their experience running mutual funds. But for alternative funds, many of these managers have run similar strategies in hedge funds or separate accounts. To the extent managers disclose their past performance in other vehicles, we take this experience into account. (Morningstar has one of the largest hedge fund databases in the industry, with almost 7,500 funds.)

When we assess an alternative manager's experience, we are assessing his or her experience shorting and managing risk. These skills are not particularly a concern for traditional mutual funds, which are often required to be fully invested and tied to a strict benchmark. In contrast, alternative mutual funds have the ability to significantly vary in market risk exposure, and widely accepted benchmarks do not exist for alternative strategies. Besides experience with shorting and risk management, though, another factor that concerns alternative funds more than many traditional funds is key-man risk. Because many alternative funds are advised by boutique firms, the decision-making can often come from one person. Take Merk Hard Currency **MERKX**, a short-U.S. dollar fund run by Axel Merk. Although Merk has worked hard to establish a repeatable investment process, he often calls the shots.

Finally, if a manager is heavily invested in his or her own fund, we typically have more confidence in its future performance. Skin in the game aligns the managers' interests with those of shareholders. In traditional stock and bond mutual funds, it's not uncommon to find a manager with more than $1 million invested in his or her own products. With alternative products, a large investment in one particular strategy is not always prudent. Take market-neutral equity strategies, for example. These funds hope to earn a couple of percentage points above cash in virtually every market environment. With near-zero interest rates, a manager may not want to allocate his or her life savings to such a low-return strategy. Nevertheless, there are managers in almost every alternative category with $1 million or more invested in their funds (Evan Dick of Highbridge Statistical Market Neutral **HSKAX**, for example. See Exhibit 1). We tend to give these managers higher People ratings.

Exhibit 1: Highbridge Statistical Market Neutral, People Snapshot

Experience and Asset Load



Management Team

Number of Managers	Longest Tenure
4	6.83 Years
5-Year Manager Retention Rate (Firm-wide)	**Largest Manager Investment in Fund**
92%	More than $1mil (USD)
Advisor	**Subadvisor**
J.P. Morgan Invesment Management, Inc	Highbridge Capital Management, LLC

Evan Dick / 11-2005 to present

Years of Experience	Investment in Fund	Fund AUM	Current Funds Managed
4	6.83 Years	$697mil (USD)	1

Largest Funds Managed	Tenure Dates	Role	Fund Size $Mil USD	Investment $Mil USD	Turnover Ratio Avg	Tenure Ret %	Index Ret %
Highbridge Statistical Mkt Neutral Fund	11-05 to Present	Lead	697.47	>1	632	0.56	2.48

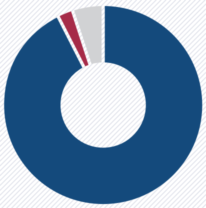
Parent

This pillar measures the quality of the fund's advisor and board of directors. Again, we are looking for an alignment of interests between the fund shareholders and the people who control the destiny of a fund. In terms of an advisor, we tend to favor shops in good regulatory standing whose employees are compensated based upon the performance of the funds they manage, rather than the firm's revenue or assets under management. We also like when firms encourage managers to invest in their own funds. In addition, we prefer fund companies that carefully determine their product lineup and launch funds that represent their core strengths rather than the strategy du jour. These characteristics can be found in any type of mutual fund, traditional or alternative. One example of a standout alternative advisor/fund company is TFS capital, which manages TFS Market Neutral **TFSMX** and TFS Hedged Futures **TFSHX**. This 100% employee-owned firm requires its principals to invest 50% of their liquid net worth in the funds (see Exhibit 2).

An independent, qualified, and vested board of trustees is also the mark of a good parent. The trustees are responsible for keeping fees low and for closing funds nearing capacity, two factors that affect a fund's performance. Alternative funds' "parent" considerations may differ from traditional mutual funds in that many alternative mutual funds are part of series trusts, which incorporate multiple (sometimes well over 50) unrelated funds. Funds that take part in a series trust are much cheaper to launch than funds that set up their own trusts. The downside to series trusts, however, can be that the trustees may not have a vested interest in the funds they oversee. If the trustees are spread thin, are highly paid, and have little or no investment in the funds they oversee, we would lean toward a negative Parent rating. Northern Lights is one example of a less-than-desirable board structure, with nearly 100 funds under its umbrella (many of them alternative). The total compensation to each of its five trustees (as of Dec. 31, 2011) ranged from $40,000 to $105,000 annually, and not one trustee had an investment in any of the funds.

Exhibit 2: TFS Market Neutral, Parent Pillar Snapshot
Fund Family Details / United States

Morningstar Rating Breakdown

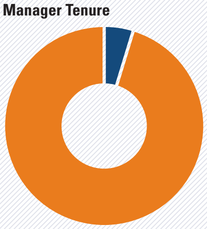


Rating	Assets %
★★★★★	92.7
★★★★★	2.6
★★★★★	0.0
★★★★★	0.0
★★★★★	0.0
Not rated	4.8
Success Ratio	100%

Fee Quintile Breakdown

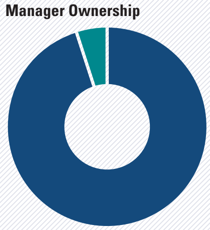
Rating	Share Class %
Low	0.0
Below Avg	0.0
Average	0.0
Above Avg	0.0
High	100.0

Manager Tenure



Rating	Assets %
0–3	4.8
3–6	0.0
6–9	95.2
9–12	0.0
12–15	0.0
15+	0.0
Retention Rate (5-Year)	100%

Manager Ownership



Rating	Assets %
Over 1 Mil	95.2
500K–1 Mil	0.0
100K–500K	0.0
50K–100K	0.0
0–50K	0.0
None	4.8
No Data	0.0

Process Is Paramount

A transparent, repeatable process earns big points toward a fund's overall rating. If past performance is not indicative of future results, surely a solid investment process behind the good numbers bodes well for the future. For example, IQ Alpha Hedge Strategy **IQHIX** follows a transparent rules-based approach to replicating a variety of hedge fund strategies. Hedge fund replication is certainly nothing new, but this four-year-old fund's momentum-based strategy allocation has allowed it to outperform its hedge fund replication peers as well as the multialternative category average since inception.

For less indexlike, more active approaches, the investment process is more difficult to analyze. In general, for fundamental discretionary alternative strategies, we like funds that incorporate a top-down point of view, given how macroeconomic concerns have driven markets during the last five years. For quantitative strategies, we like processes that take into account transaction costs (as many quantitative funds are highly diversified and have high turnover) and processes that use a human element to evaluate the effectiveness of the models.

Regarding both discretionary and quantitative strategies, though, we focus on how the fund shorts and manages risk. Shorting is more difficult than going long. Timing is critical, because as a short position rises in price, the position becomes larger in the portfolio. Shorting can also be costly. One must pay any dividends or coupons, as well as a fee to borrow if the security is particularly illiquid. Wasatch Long/Short **FMLSX** has a good shorting process relative to its long-short equity peers. Manager Mike Shinnick uses the same fundamental value process to identify possible long and short positions, but short candidates must have a specific catalyst that management believes will cause a near-term price decline. Shinnick also uses technical analysis to time his positions, and he limits each short position to 3% of the portfolio value.

Diamond Hill Long-Short **DIAMX**, on the other hand, has a much looser shorting process and has paid the price for it more than once.

In terms of risk management, part of every alternative fund's directive is to control risk. Whereas traditional funds must generally be fully invested and must track a benchmark, part of an alternative fund's value-add is to protect against downside risk. Turner Spectrum **TSPEX**, for example, a multimanager long-short equity fund, has a lockdown policy that reduces gross equity exposure in the event of a 5% intramonth drawdown. AQR Managed Futures Strategy **AQMIX**, as another example, targets 10% volatility and reduces risk in five equal steps if the volatility target is breached.

Performance

In the end, performance is what matters. And whether a fund follows a traditional or alternative strategy, performance is relative: relative to peers, relative to market exposure, and relative to the cheapest substitute (a similar exchange-traded fund, for example). There are different ways of slicing and dicing performance as well; just looking at total return does not give an investor a clear idea of a fund's risk and return profile. That's why we created the Morningstar Rating. It measures how a fund ranks relative to its category peers in terms of risk-adjusted return. It's similar to the Sharpe ratio, but it takes into account a fund's tail risks as well.

Unfortunately, the Morningstar Rating can only be calculated using a minimum of 36 months of returns, which means that many alternative funds are not rated. Morningstar calculates several metrics beside the Morningstar Rating, though, to help investors assess its historical risk and return. Alpha is probably the most important, as alpha measures an active manager's skill, and most alternative funds are actively managed. The key to calculating alpha is selecting the best benchmark index.

For this, we look at a fund's portfolio holdings as well as the Morningstar Best Fit Index. For example, JP Morgan Strategic Income Opportunities' **JSOAX** prospectus says, "the Fund has an absolute return orientation, which means that it is not managed to an index." Looking at the portfolio holdings of the fund, however, it's clear that it concentrates on high yield. Morningstar's Best Fit Index for the fund is also a high-yield index (versus the index listed in the prospectus, Barclays US Universal Index; see Exhibit 3).

Of course, strategies like merger arbitrage and managed futures have no widely accepted or widely available benchmark indexes. We would then compare these funds' returns with that of their category average or a smaller subset of peers within the category. Another option is to compare them with our hedge fund category indexes representing the same strategies (the Morningstar MSCI Systematic Trading Hedge Fund Index is an index of managed-futures funds, for example), or ETFs/ ETNs that follow similar but more-indexed strategies (WisdomTree Managed Futures **WDTI**, for example). When comparing returns, risk-adjusted measures such as the Sharpe or Sortino ratios are more prudent than total return measures.

Finally, it's important to look at returns in different types of market environments: upside/ downside capture ratios, which look at returns when the benchmark index is positive or negative, respectively; bear correlation, which measures the correlation of a fund to a benchmark in negative months; maximum drawdown, which measures the fund's worst loss over a period of time using monthly returns; and the returns of the fund during periods of stress for a particular strategy (for example, 2011 was a horrendous year for managed-futures funds).

Exhibit 3: JPMorgan Strategic Income
Relative Performance 11-1-2008 to 08-31-2012

	Benchmark 1	Benchmark 2
Excess Return	–12.79	–1.11
Alpha	–0.83	2.95
Beta	0.44	0.55
R-Squared	73.54	8.65
Tracking Error	7.34	5.93
Information Ratio	–1.74	–0.19
Treynor Ratio	17.87	14.13
Up Capture Ratio	40.72	78.77
Down Capture Ratio	42.75	16.97
Up Number Ratio	0.83	0.74
Down Number Ratio	0.90	0.63
Up Percentage Ratio	0.00	0.47
Down Percentage Ratio	1.00	0.50

Benchmark 1: BofAML US HY Master II
Benchmark 2: Barclays US Universal

The Price Is Right

There's no such thing as a free lunch, of course. But Morningstar believes, as do the academics, that the more a fund charges relative to its peers, the worse it will perform over time. We also believe that strategies in more-efficient asset classes such as large-cap stocks should charge less than strategies in less-efficient classes, such as emerging-markets stocks. Similarly, it makes sense that alternative funds are generally more expensive than traditional funds, as they require more trading and risk-management skill, and as there are few cheaper substitutes such as ETFs.

But even in alternative strategies, there are decently priced options. For example, Gateway Fund **GATEX** charges only 94 basis points for its A shares, much less than the average long-short equity fund (2.04%, the average of all share classes of all funds in the long-short equity category), and much less than other A share alternative (including other categories) mutual funds, which charge an average of 1.74% (see Exhibit 4). Performance, naturally, factors into the mix. Just because a fund is cheap doesn't mean it's good. But if a fund is already good, a reasonable price tag bolsters our confidence in its future performance.

The Results

So far, we have rated 45 alternative mutual funds in six categories, representing 75% of the alternative mutual fund assets. Most of these initial ratings were determined in the second quarter, so it is difficult to assess our results over such a short time frame. Nevertheless, Exhibit 5 shows the year-to-date returns of each of the rated funds in each category against the category average through Sept. 18. An Analyst Rating of Gold, Silver, or Bronze indicates a positive outlook.

Exhibit 4: Gateway Fund, Price Snapshot
Expense Breakdown

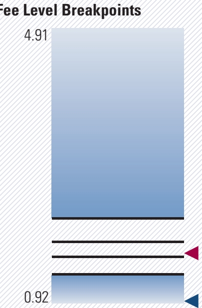
Net Expense Ratio	%
Annual Report 12-31-2011	0.94
Prospectus 06-30-2012	0.94

Selected Components	%
Management Actual	0.65
12b-1 Fee	0.25
Brokerage Commission (% of Avg Net Assets)	0.06
Category Average	0.73
Tax Cost Ratio (3-Year)	0.55
Potential Capital Gains Exposure	9

Fee Level

Fee Level	Peer Group
Low	Long Short/Market Neutral Front Load

Fee Level Breakpoints



High	>2.26
Above Avg	1.90–2.26
Average	1.68–1.90
Below Avg	1.40–1.68
Low	<1.40
◀ Fund	0.94
◀ Peer Median	1.74

In the currency category, all of our positive ratings beat the category average. In the long-short equity category, all but one of the positively rated funds beat the category average, while the two Negative ratings fell short of the average as expected. In managed futures, our one positive rating beat the category average, but only one of the two Negative ratings fell short of the category average as expected. For market-neutral funds, all but one of our five positive ratings beat the category average. Our multialternative rating results were more mixed. One of our positive ratings beat the average, while the other two lagged. Finally, in nontraditional bond, most of our ratings are Neutral because this category is so heterogeneous (some strategies take long and short bets on interest rates, while others focus on emerging-markets debt, for example). Our single positive rating did beat the category average, however.

While our ratings are off to a good start, our outlook is longer term. We believe alternatives hold a permanent place in investors' portfolios, and therefore the Morningstar Analyst Ratings are in it for the long run. M

Exhibit 5: Initial Alternative Fund Forward-Looking Analyst Ratings Year-to-Date Performance

	Ticker	Total Return YTD (9-18-12)	Morningstar Analyst Rating
Currency			
Lord Abbett Emerging Markets Currency A	LDMAX	9.33	Neutral
PIMCO Emerging Markets Currency A	PLMAX	6.67	Silver
Franklin Templeton Hard Currency A	ICPHX	4.03	Silver
Merk Hard Currency Inv	MERKX	3.90	Silver
US OE Currency		**2.35**	
JHancock2 Currency Strategies A	JCUAX	1.52	Neutral
Long/Short Equity			
Marketfield	MFLDX	12.77	Bronze
Wasatch Long/Short	FMLSX	9.18	Silver
Diamond Hill Long-Short A	DIAMX	8.90	Neutral
Forward Tactical Growth C	FTGOX	7.50	Neutral
Gateway A	GATEX	5.50	Silver
Schooner A	SCNAX	5.44	Bronze
US OE Long/Short Equity		**5.01**	
Quaker Event Arbitrage A	QEAAX	5.00	Neutral
The Collar	COLLX	3.17	Bronze
Aberdeen Equity Long-Short C	MLSCX	2.56	Negative
Turner Spectrum Instl	TSPEX	0.00	Neutral
Quaker Akros Absolute Return A	AARFX	–4.59	Neutral
Hussman Strategic Growth	HSGFX	–13.03	Negative
Managed Futures			
MutualHedge Frontier Legends A	MHFAX	0.30	Neutral
AQR Managed Futures Strategy I	AQMIX	–0.10	Silver
Princeton Futures Strategy A	PFFAX	–0.83	Negative
Altegris Managed Futures Strategy A	MFTAX	–1.02	Neutral
US OE Managed Futures		**–4.63**	
Natixis ASG Managed Futures Strategy A	AMFAX	–7.36	Neutral
Guggenheim Managed Futures Strategy A	RYMTX	–10.07	Negative
Guggenheim L/S Commodities Strategy A	RYLBX	–23.38	Neutral

	Ticker	Total Return YTD (9-18-12)	Morningstar Analyst Rating
Market Neutral			
TFS Market Neutral	TFSMX	5.87	Gold
JPMorgan Research Market Neutral Instl	JPMNX	4.51	Bronze
Merger	MERFX	2.69	Silver
AQR Diversified Arbitrage I	ADAIX	2.02	Silver
US OE Market Neutral		**1.26**	
Highbridge Statistical Mkt Neutral A	HSKAX	0.34	Neutral
Arbitrage R	ARBFX	–0.08	Silver
DWS Disciplined Market Neutral A	DDMAX	–1.06	Neutral
Multialternative			
IQ Alpha Hedge Strategy Inst	IQHIX	4.60	Bronze
US OE Multialternative		**3.52**	
Van Eck Multi-Manager Alternatives A	VMAAX	2.90	Neutral
Goldman Sachs Absolute Return Tracker A	GARTX	2.84	Negative
Natixis ASG Global Alternatives A	GAFAX	2.44	Neutral
Hatteras Alpha Hedged Strategies	ALPHX	2.19	Negative
Absolute Strategies I	ASFIX	1.27	Silver
AQR Multi-Strategy Alternative I	ASAIX	–0.62	Neutral
Natixis ASG Diversifying Strategies A	DSFAX	–4.00	Bronze
Nontraditional Bond			
Forward Credit Analysis Long/Short Instl	FLSIX	11.28	Neutral
PIMCO Floating Income A	PFIAX	9.99	Neutral
Goldman Sachs Strategic Income A	GSZAX	9.29	Neutral
PIMCO Unconstrained Bond A	PUBAX	7.35	Bronze
JPMorgan Strategic Income Opps A	JSOAX	6.40	Neutral
US OE Nontraditional Bond		**5.82**	
Eaton Vance Multi-Strat Absolute Ret A	EADDX	1.74	Neutral

Quant Corner: Alpha, Beta, and Now…Gamma

Measuring the importance of intelligent financial-planning decisions.

by
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The potential benefits from "good" financial-planning decisions are often difficult to quantify. For any given portfolio, investment decisions can generally be decomposed into two primary components: beta and alpha. Beta can generally be defined as the systematic risk exposures of the portfolio (usually achieved through asset allocation), while alpha is the residual, or skill/luck-based, component associated with the various flavors of active management (for example, tactical asset allocation, security selection, and more). Alpha and beta are at the heart of traditional performance analysis; however, their impact on a successful retirement can be far less important than other financial-planning decisions can.

In this article we introduce a new concept called "Gamma" that is designed to measure the additional expected retirement income achieved by an individual investor making more-intelligent financial-planning decisions. Gamma is the third letter in the Greek alphabet (preceded by alpha and beta), and within financial economics it is sometimes used as the variable denoting an investor's degree of risk aversion. Given that Gamma is relatively unclaimed within financial literature, we seek to give it new meaning. Gamma varies for different investors as well as for investors in different lifecycles (for example, accumulation versus retirement). For those who find it hard to break from traditional (and inadequate) performance measurement, Gamma is a metric that is somewhat comparable to alpha, or excess return, but even more than that, it is the return that an investor experiences based on optimal financial decision-making.

In calculating Gamma, we focus on five important financial-planning decisions/techniques: a total wealth framework to determine the optimal asset allocation, a dynamic withdrawal strategy, the incorporation of guaranteed income products (that is, annuities), tax-efficient allocation decisions, and a portfolio optimization that includes liabilities. Each of these five Gamma components creates value for retirees, and when combined, they can be expected to generate 29% more income on a utility-adjusted basis when compared with a simplistic static withdrawal strategy (according to our analysis). This additional income is equivalent to an arithmetic "alpha" of 1.82% (that is, Gamma-equivalent alpha) and thereby represents a significant potential increase in portfolio efficiency (and retirement income) for retirees.

Alpha and Beta: Defining Value

The notions of beta and alpha (in particular alpha) have long fascinated financial advisors and their clients. Alpha allows a financial advisor to demonstrate (and potentially quantify) the excess returns generated in an investment portfolio, which can help justify fees. In contrast, beta (systematic risk exposures) helps explain the risk factors of a portfolio relative to the market (that is, the asset allocation).

If an advisor is paid solely to manage a portfolio of assets and does nothing else (that is, he offers no additional advice regarding anything other than the investment of the client assets), the concepts of alpha and beta should be relatively good measures of the advisor's value. However, in more-complex engagements, in particular as it relates to providing financial-planning services to clients, value cannot be defined in such simple terms as alpha and beta because the objective of an individual investor is typically to achieve a goal, and that goal is most likely saving for retirement.

It may be that a financial advisor generates significant negative alpha for a client (for example, she invests the client's money in very expensive mutual funds that underperform) but still provides other valuable services that enable a client to achieve his goals. While this financial advisor may have failed from a pure alpha perspective, the underlying goal was accomplished. This is akin to losing the battle but winning the war.

Individual investors invest to achieve goals (typically an inflation-adjusted standard of living). Doing the things that help an investor achieve these goals (that is, adding Gamma) is a different type of value than that which can be attributed to alpha or beta alone, and is in many ways more valuable. Therefore, metrics such as alpha and beta are an incomplete means of measuring retirement-strategy performance.

Gamma Factors

In this article, we examine the potential value, or Gamma, that can be obtained from making "intelligent" financial-planning decisions during retirement. A retiree faces a number of risks during retirement, some unique to retirement planning and not concerns during accumulation. We will explore five Gamma factors:

1 **Total Wealth Asset Allocation**
Using human capital (that is, future potential savings) in conjunction with the investment portfolio (financial capital) to determine the optimal equity allocation. Most techniques used to determine the asset allocation for a client focus only on the investment portfolio and are relatively subjective; they focus primarily on risk preference (that is, an investor's aversion to risk) rather than risk capacity (that is, an investor's ability to assume risk). In practice, however, we believe asset allocation should be based on total wealth (a combination of human and financial capital) and on a combination of risk preference and risk capacity, with an emphasis on risk capacity. We determine an investor's risk capacity (or target equity allocation) by evaluating his or her total wealth. We can then either use the market portfolio as the target aggregate asset allocation for each investor (as suggested by the Capital Asset Pricing Model) or build an investor-specific asset allocation that incorporates an investor's risk preferences. In both approaches, the financial assets are invested (subject to certain constraints) to achieve an optimal asset allocation for total wealth.

2 **Dynamic Withdrawal Strategy**
The majority of retirement research has focused on static withdrawal strategies where the annual withdrawal during retirement is based on the initial account balance at retirement and increased annually for inflation. For example, a "4% withdrawal rate" would really mean a retiree can take a 4% withdrawal of the initial portfolio value and continue withdrawing that amount each year, adjusted for inflation. If the initial portfolio value was $1 million and the withdrawal rate was 4%, the retiree would be expected to generate $40,000 in the first year. If inflation during the first year was 3%, the actual cash flow amount in year two (in nominal terms) would be $41,200. The approach we use in this paper, originally introduced by Blanchett, Kowara, and Chen (2012), determines the annual withdrawal amount annually based on the ongoing likelihood of a portfolio's survivability (due to market performance) and expected investor longevity.

3 **Annuity Allocation**
Outliving one's savings is perhaps the greatest risk for retirees. A study by Allianz Life noted that the greatest fear among retirees is not death (39%) but rather outliving one's resources (61%). (See Bhojwani [2011].) Annuities allow a retiree to hedge away this risk and can therefore improve the overall efficiency of a retiree's portfolio. The benefits, risks, and costs of an annuity in the context of a total portfolio must be considered before determining the appropriate amount and annuity type.

4 **Asset Location and Withdrawal Sourcing**
Tax-efficient investing for a retiree can be thought of in terms of both "asset location" and intelligent withdrawal sequencing from accounts that differ in tax status. Asset location is typically defined as placing (or locating) assets in the most tax-efficient account type. For example, it generally makes sense to place less tax-efficient assets (that is, those where the majority of total return comes from coupons/dividends taxed as ordinary income), such as bonds, in retirement accounts (for example, IRAs or 401(k)s) and more tax-efficient assets (that is, those where the majority of total return comes from capital gains taxed at a rate less than ordinary income), such as stocks, in taxable accounts. When thinking about withdrawal sequencing, it typically makes sense to withdraw monies from taxable accounts first and more tax-efficient accounts (for example, IRAs or 401(k)s) later.

5 **Liability-Relative Optimization**
Asset-allocation methodologies commonly ignore the funding risks, like inflation and currency, associated with an investor's goals. By incorporating liabilities into the portfolio-optimization process, it is possible to build portfolios that can better hedge the risks faced by a retiree. While these "liability-driven" portfolios may appear to be less-efficient asset allocations when viewed from an asset-only perspective, we find they are actually more efficient when it comes to achieving a sustainable retirement income.

These five Gamma concepts can be thought of as actions and services provided by financial planners. Bennyhoff and Kinniry (2011) called them "Advisor's alpha" and Scott (2012) labeled them "household alpha." However, Bennyhoff and Kinniry do not attempt to quantify the potential benefit of these actions. The goal of this article is to provide some perspective on, as well as to quantify, the potential benefits that can be realized by an investor (in particular a retiree) from using a Gamma-optimized portfolio.

Gamma

First, let's define Gamma. The Gamma of a retirement-income strategy is defined in equation 1, where Y is the utility-adjusted income generated from a given strategy. For those readers not familiar with the concept of utility, it is an approach to quantify the satisfaction derived from some set of goods or services. In this case, we assume that the utility of income is an increasing concave function so that the higher the level of income, the lower the increase in utility of additional income. Thus, the amount of utility an investor gets for each dollar of income is not equal. A more detailed explanation of Gamma can be found in the full version of this study: **http://corporate.morningstar.com/ib/documents/PublishedResearch/AlphaBeta-andNowGamma.pdf**

$$\textit{Gamma (Strategy)} = \frac{Y\,(\textit{Strategy}) - Y\,(\textit{Benchmark})}{Y\,(\textit{Benchmark})}$$

Gamma Results

In this section we will review the relative impact of five kinds of Gamma: a total wealth framework to determine the optimal asset allocation, a dynamic withdrawal strategy, the incorporation of guaranteed income products, tax-efficient allocation decisions, and liability-relative portfolio optimization.

If we add the results from the five types of Gamma tested, we find a Gamma of 28.8%, meaning $1.29 for every $1 generated by the base set of assumptions. The base case is retirees (males and females both aged 65) who follow the aforementioned 4% withdrawal scenario and invest in a 20% equity/80% fixed-income portfolio. (The performance of the portfolio is determined by Ibbotson capital market assumptions and Monte Carlo simulation.) We display this concept visually in Exhibit 1, which shows the incremental and total income generated by each of the Gamma tests.

Exhibit 1: More Retirement Income With Gamma-Optimized Portfolios

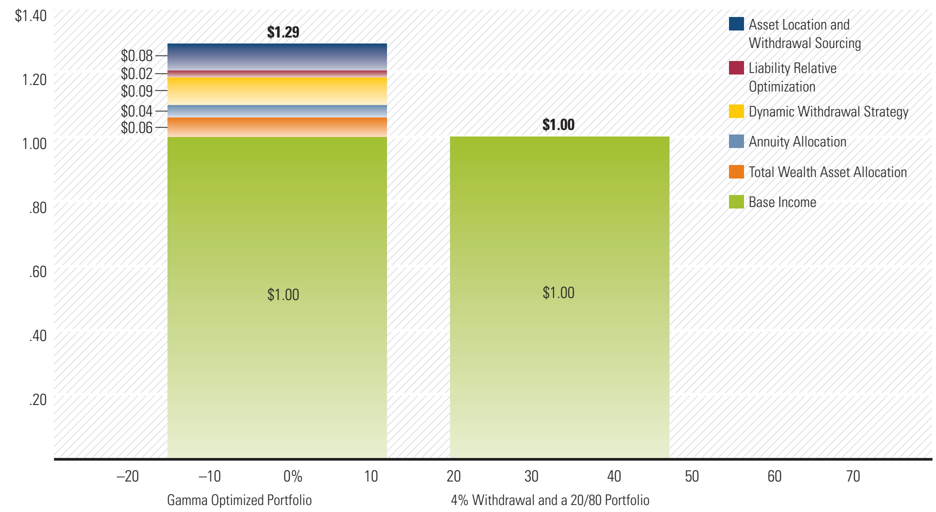
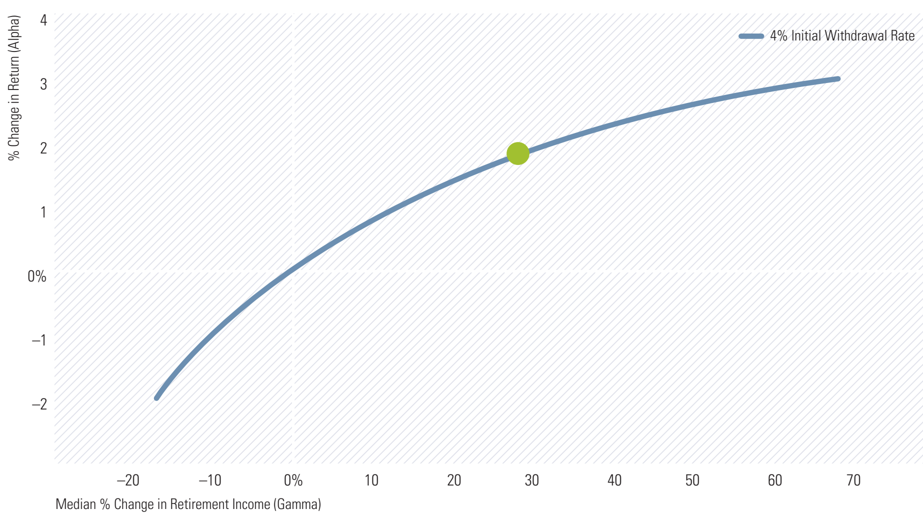


Exhibit 2: Relationship Between Additional Retirement Income and Changes in Returns for a 4% Initial Withdrawal Rate



An increase in certainty-equivalent (utility-adjusted) income of 28.8% is an impressive improvement in potential retirement income, but how does it relate from a traditional alpha perspective? In order to determine how much additional annual return, or alpha, is equivalent to the 28.8% Gamma, we conducted an additional analysis. We determined the median income generated for the initial withdrawal rate (4%) and compared it with the median income generated for portfolios with returns that are either higher or lower than the base portfolio by negative 2%, negative 1%, 0% (no change), positive 1%, positive 2%, and positive 3%. We show these results in Exhibit 2. Exhibit 2 demonstrates that a 10% increase in median retirement income is equivalent to an extra 1% annualized return (or Gamma-equivalent alpha) in the base portfolio. A 28.8% increase is equivalent to a 1.82% annualized alpha.

Table 1 shows how we attribute this Gamma-equivalent alpha among the five Gamma factors. This is likely to be significantly higher than any type of portfolio "alpha" that a financial advisor would be able to generate through fund selection or market-timing. Also, while traditional portfolio alpha is a negative-sum game (because everyone cannot, on average, outperform the market), our results show that Gamma is not a zero-sum game and can be achieved by any investor who takes a smarter approach to generating retirement income.

Table 1: Additional Income Amounts and Gamma-Equivalent Alpha Values

Gamma Type	Additional Income Generated %	Gamma Equivalent Alpha %
Total Wealth Asset Allocation	6.1	0.38
Annuity Allocation	3.8	0.24
Dynamic Withdrawal Strategy	8.5	0.54
Liability Relative Optimization	2.2	0.14
Asset Location and Withdrawal Sourcing	8.2	0.52
Total	**28.8**	**1.82**

Conclusion

In this article, we introduce a new concept called "Gamma." We define Gamma as the additional value achieved by an individual investor if making more-intelligent financial-planning decisions. While Gamma varies for different types of investors, in this article we focus on five types of Gamma relevant to retirees: a total wealth framework to determine the optimal asset allocation, a dynamic withdrawal strategy, the incorporation of guaranteed income products, tax-efficient allocation decisions, and liability-relative portfolio optimization. Among the five types of Gamma tested, the use of a dynamic withdrawal strategy was determined to be the most important, followed by tax-efficient allocation decisions. Each of these five components is either currently being used in, or is in development to be used in, Morningstar Retirement Manager or Ibbotson's Wealth Forecasting Engine.

In the aggregate we estimate a retiree can be expected to generate 29% more income on a certainty-equivalent utility-adjusted basis utilizing a Gamma-efficient retirement-income strategy when compared with our base scenario of a 4% withdrawal rate and a 20% equity allocation portfolio. This additional income is equivalent to an average annual return increase of positive 1.82% (that is, Gamma-equivalent alpha), which represents a significant improvement in portfolio efficiency for a retiree. The appeal of Gamma is that it is much easier to achieve than standard portfolio alpha.

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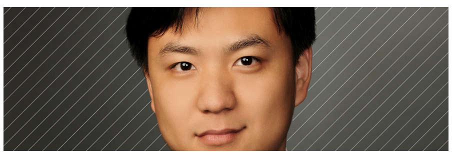
Morningstar Product Spotlight: Bear Correlation

It pays to focus more on the 'bad' correlation.



by
Terry Tian
Alternative Investments Analyst

Correlation has become a buzz word for investors who are considering alternative strategies. Correlation measures how a fund's return moves in relation to an index benchmark; the lower the correlation, the more diversification benefits investors can get. Besides the standard way of calculating correlation, Morningstar offers a supplementary data point called Morningstar Bear Correlation, which provides insights into a fund's correlation to a benchmark only in down months. Bear correlation and its sister data point Morningstar Bull Correlation can be found in Morningstar Direct℠ and Morningstar Office℠ by searching in the Edit Data dialogue box.

Bear Correlation

Bear correlation calculates the annualized monthly correlation between an investment and a selected benchmark index in the months when the selected benchmark index delivers negative returns. For example, over the past 10 years (August 2002 to July 2012), the S&P 500 Index posted 78 positive monthly returns and 42 negative monthly returns. Therefore, a fund's 10-year bear correlation with the S&P 500 is calculated using the 42 negative-return monthly observations. Correlation and bear correlation can also be calculated using weekly data.

A fund's bear correlation to the stock market (as represented by the S&P 500 Index) can significantly differ from its overall correlation. A high bear-market correlation means that a fund will suffer at the same time as the broad market will, lessening its diversification benefits. Of course, correlations are period-dependent and ever-changing. One can never know whether historical correlations will persist. A clear trend is emerging, however: Correlations across the board are rising.

Changing Landscape of the Correlation World

Over the past decade, globalization and financial innovation (the proliferation of derivatives and exchange-traded products in particular) have fundamentally changed the investment world. While global markets are now much cheaper and easier to gain access to, rising correlations, both within and across asset classes, appear to be the collateral damage. For example, the correlation between high-yield bonds (as represented by the Bank of America Merrill Lynch U.S. High Yield BB-B Constrained TR Index) and the S&P 500 Index rose to 0.52 in 2011 from 0.05 in 2002 (using annualized weekly data).

Because correlations have risen over the past few years, we divided our study of the past 10 years (521 weeks) into two periods: Aug. 4, 2002, to July 28, 2007, which is largely a bull market (the S&P 500 Index delivered 151 positive weekly returns and 109 negative weekly returns during this period); and July 29, 2007, to July 28, 2012, which incorporates the financial crisis and a rapid equity market rebound (the S&P 500 Index posted 121 negative weekly returns and 140 positive ones during this period). We used weekly return observations in order to generate statistically meaningful results.

We then calculated the overall correlations and bear correlations over the two five-year periods between each of Morningstar's 59 U.S. open-end mutual fund category averages and the S&P 500 Index and plotted them on Exhibit 1. The overall correlation is represented on the y-axis, while the bear correlation appears on the x-axis. The 59 mutual fund categories include U.S. and international stocks, sector stocks, government and taxable bonds, and allocation funds (excluding alternative categories).

The 45-degree line on Exhibit 1 demonstrates a one-to-one relationship between a category average's overall correlation to the S&P 500 and its bear correlation to the S&P 500. If an observation falls above the line, the category average exhibited a lower bear correlation to

Exhibit 1: Overall vs. Bear-Market Correlation for 59 Mutual Fund Category Averages August 2002 to July 2007 (weekly data)

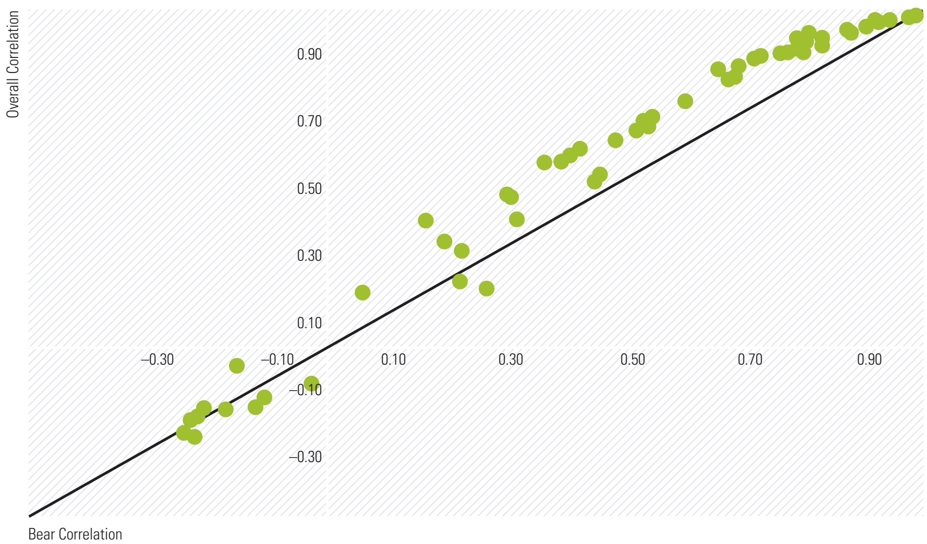
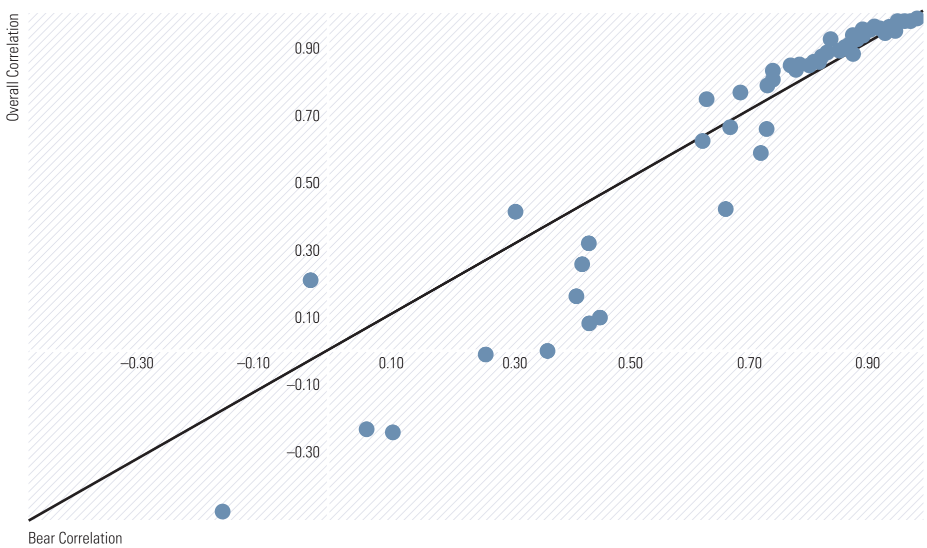


Exhibit 2: Overall vs. Bear-Market Correlation for 59 Mutual Fund Category Averages August 2007 to July 2012 (weekly data)



the index than its overall correlation. Conversely, observations below the line resulted from a higher correlation to the S&P 500 Index in bear markets.

No Place to Hide

Comparing Exhibits 1 and 2, it's clear that correlations have dramatically risen between the first and second halves of the past decade. First, more observations clustered in the upper-right corner of Exhibit 2, meaning that many of the 59 category averages exhibited higher overall correlations and higher bear-market correlations to the S&P 500 Index in the second half of the decade. Specifically, between 2002 and 2007, only 13 of the 59 category averages exhibited bear-market correlations to the S&P 500 in excess of 0.8, and only 28 of 59 categories demonstrated an overall correlation to the S&P 500 in excess of 0.8. From 2007 to 2012, however, these numbers grew to 36 and 41, respectively.

International-stock funds showed the most dramatic leaps in correlation. For example, the diversified Pacific/Asia category average used to provide strong diversification benefits to stock investors, with a 0.41 bear correlation and a 0.57 overall correlation to the S&P 500 Index in the first half of the decade, but the correlations nearly doubled to 0.82 and 0.85, respectively, after 2007.

Second, more observations have moved across the diagonal line to the bottom-right side of Exhibit 2, meaning the bear correlations are higher than the overall correlations to the S&P 500 for many types of funds in the most recent five-year period. In the first five years, 51 of 59 categories' bear correlations were lower than their overall correlations, and for 43 of them, the difference was larger than 0.05. Since 2007, only 43 of 59 categories exhibited lower bear-market correlations, and only 13 were markedly lower (more than 0.05).

The most astonishing change happened in the multisector-bond category. Funds in this category were essentially uncorrelated to the S&P 500 Index in the first half of the decade, especially when looking at the bear correlations. In the second half of the decade, however, the bear correlation rose to 0.72 from 0.06 and the overall correlation increased to 0.59 from 0.16.

These data suggest that diversifying among traditional stock and bond strategies by sector or geography may have worked in the first half of the past decade, but, more recently, the diversification benefits have dissipated. If traditional funds' correlations to equities stay at higher levels or continue to rise, investors will have to find a new way to invest. Alternative investments could be the answer.

An Alternative Way

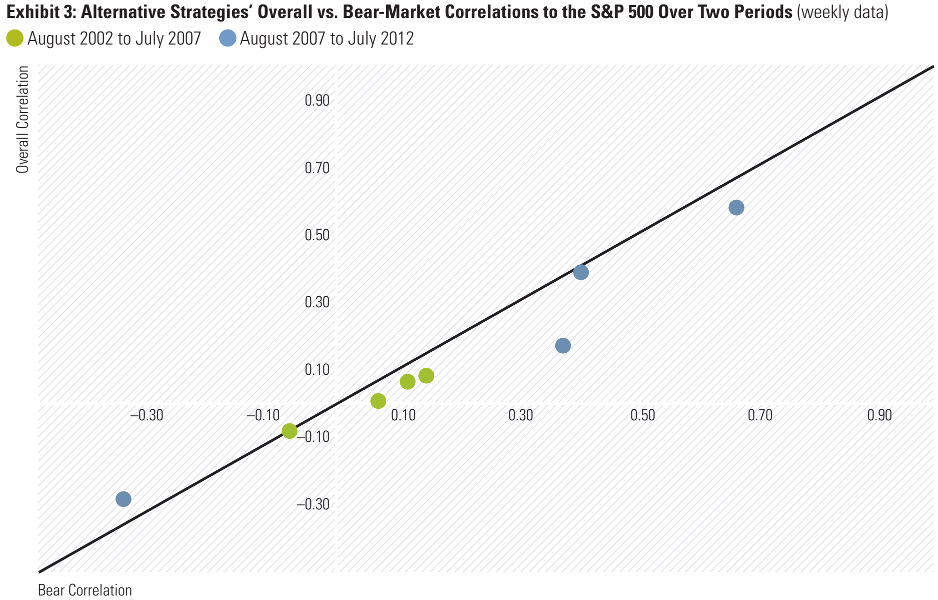
Alternative investments, funds that invest in different asset classes (such as commodities or currencies) or take long and short approaches to traditional asset classes, seem to be an answer to the high-correlation, low-diversification problem. We examined four alternative fund categories that are commonly believed to be uncorrelated with the stock market—currency, market neutral, managed futures, and nontraditional bond—and tested how their correlations changed over the past 10 years. (Because of the short track records of managed-futures mutual funds, we replaced the category average with the S&P Diversified Trends Indicator, or S&P DTI, Index. We also used the Inverse U.S. Dollar Index to represent the currency mutual funds.) The results are displayed in Exhibit 3.

The green observations in Exhibit 3 represent the overall and bear-market correlations of the four alternative category averages to the S&P 500 Index over the first five-year period (using weekly data). It's apparent that the correlations are clustered near zero. Conversely, the blue observations represent the correlations of these same four category averages to the S&P 500 over the past five-year period. Although some of these correlations are still relatively low, they are significantly more positive than in the previous five-year period.

Market neutral's overall and bear correlations, for example, rose to 0.17 from negative 0.08 and to 0.38 from negative 0.08, respectively. The market-neutral category includes convertible-arbitrage funds, which suffer during periods of illiquidity such as the one experienced in 2008, and merger-arbitrage funds, which suffer during periods of economic uncertainty when deals break. Therefore, their bear correlations rose much further than the overall correlation, pushing the category average to the bottom-right side of the diagonal line. The two oldest merger-arbitrage funds, Merger **MERFX** and Arbitrage **ARBFX**, saw their bear correlations rise to 0.66 and 0.69 postcrisis from 0.5 and 0.53 precrisis, respectively.

Currency funds' (as represented by the Inverse U.S. Dollar Index) correlations between the past two five-year periods also moved upward in Exhibit 3. Since 2008, the correlation

Exhibit 3: Alternative Strategies' Overall vs. Bear-Market Correlations to the S&P 500 Over Two Periods (weekly data)



S&P Diversified Trends Indicator was incepted on Dec. 31, 2003, so the correlation calculations for the S&P DTI begin on Jan. 4, 2004.

between a weak U.S. dollar and a rising S&P 500 Index has spiked to an unprecedented level. Most currency funds short the U.S. dollar (and take long positions in foreign currencies). Therefore, when the global economic outlook worsened, the U.S. dollar rose in value, and these funds suffered together with the stock markets. The Inverse U.S. Dollar Index's overall and bear correlation to the S&P 500 rose to 0.39 and 0.41 from 0.01 and 0.07, respectively.

Non-traditional-bond funds' overall and bear correlations moved much more than those of other alternative categories since 2007, to 0.58 and 0.67 from 0.07 and 0.12, respectively. This is not surprising. Although many of these non-traditional-bond funds hedge, many still take on significant credit risk, which is becoming increasingly correlated with equity risk. Credit and structured products are viewed as risky assets and have been bought and sold together with stocks in the risk-on, risk-off environment of the past few years.

Finally, managed-futures strategies (as represented by the S&P DTI) stand out in the correlation crowd. The S&P DTI Index moved from near-zero correlations with the S&P 500 Index in the first half of the decade into the negative territory in the second half. Managed-futures strategies profit from trends in various futures markets, which theoretically have no relation to the direction of stocks over time.

Except for the market-neutral category average, the alternative mutual fund strategies stayed close to the diagonal line, suggesting their overall and bear correlations to the stock market rose or declined by a similar amount.

Conclusion

In the post-2008 crisis era, most mutual fund categories have become more correlated with the stock market. The increase in bear correlation, or the correlation during downturns in the equity markets, makes it particularly difficult for investors to diversify. Relative to traditional strategies, alternative investments still provide the best diversification, though even some of these strategies' benefits have somewhat diminished. Therefore, when constructing a portfolio, investors should not rely simply on historical correlation. Statistics such as bear correlation and a little bit of judgment can help fill the information gap.

Industry Trends: Alternative Mutual Funds

A slowdown in liquid alternative launches.

by
Mallory Horejs
Alternative Investments Analyst

Alternative Mutual Funds

Only 10 new alternative mutual funds came to market during the third quarter of 2012. This figure pales in comparison to the number of new launches seen in the previous four quarters (16, 16, 24, and 17) and marks the slowest quarter of alternative mutual fund product launches since the first quarter of 2010. While investors are clearly still bullish on liquid alternatives, as evidenced by the $4.9 billion of inflows in July and August 2012, the market for some new liquid alternative products, particularly those that are similar to existing products, may be nearing a point of saturation.

Samson STRONG Nations Currency **SCAFX**, for example, a currency fund launched in August 2012, brings Morningstar's smallest alternative category up to 22 distinct funds. This offering uses a combination of top-down, bottom-up, and quantitative analysis to identify attractive developed-nation or emerging-markets currencies for investment. The team targets currencies of those nations exhibiting characteristics such as: healthy fiscal trends, a well-established rule of law, and full legal transparency. Management will make equal-weighted investments in approximately eight to 12 currencies and rebalance on a monthly basis. This strategy appears very similar to existing "hard currency" strategies in the same category.

Two new managed-futures funds also launched in the third quarter, Wakefield Managed Futures Strategy **WKFAX** and Mariner Hyman Beck **MHBAX**. Both mutual funds are structured as funds of commodity-trading advisors and offer portfolios diversified across asset classes, trading strategies, and time frames. Investors should be aware, however, that neither new offering discloses the names or strategies of their underlying managers (as of Sept. 25, 2012), and neither of the fund's prospectuses spell out the performance-based fees paid to the underlying advisors. There are eight other funds of commodity-trading advisors in Morningstar's managed-futures category, some of which disclose both the underlying advisors and fees.

Two new long-short equity offerings, Gotham Absolute Return **GARIX** and Swan Defined Risk **SDRAX**, also came to market in the third quarter. The Gotham strategy, priced at 2.25% for the Institutional shares, appears to be a typical long-short stock-picking fund, while the Swan product, priced at 1.68% for the A shares, follows an equity exchange-traded fund strategy that writes options for income and hedges with long index put options. Gateway **GATEX**, launched in 1977, is the oldest index option strategy in the long-short equity category.

For the second consecutive quarter, multialternative mutual funds experienced the highest number of product launches, most likely to meet the growing investor demand for these all-in-one alternative solutions. Four new multistrategy products launched in the third quarter: Cornerstone Advisors Public Alternatives Fund **CAALX**, GuidePath Altegris Multi-Strategy Alternative Allocation **GPAMX**, ISM Non-Traditional **FMNRX**, and Russell Multi-Strategy Alternative **RMSAX**. With 86 constituents, the multialternative category remains Morningstar's largest alternative category.

While the rate of alternative mutual fund launches does appear to be slowing, the quarterly net inflows into Morningstar's seven alternative mutual fund categories ($4.9 billion through Aug. 31) are the largest in more than a year. The currency and managed-futures categories exhibited slight outflows during the quarter, while the long-short equity, multialternative, and non-traditional-bond categories each individually netted more than $1.2 billion.

Fund Reports

Aston/River Road Long-Short

by **Josh Charney**

Advisor
Aston Asset Management LP
River Road Asset Management LLC (subadvisor)

Advisor Location
Louisville, Kentucky (subadvisor)

Assets Under Management
$7.5 million

Inception Date
May 4, 2011

Investment Type
Mutual fund

Morningstar Category
Long-short equity

Management
Lead portfolio manager Matt Moran, CFA, has 12 years of investment advisory experience. He started at River Road in early 2007 as an equity analyst and co-founded the analyst fund. Prior to joining River Road, he worked as an equity analyst covering oil services at Morningstar for two years and has five years of experience in wealth management at Goldman Sachs and Citigroup. Portfolio manager Daniel Johnson, CPA, CFA, has been with River Road since 2006, where he co-founded the analyst fund and long-short strategies. Before joining River Road, he served as a public accountant for two years with PricewaterhouseCoopers.

Strategy
This fund follows a bottom-up, value-oriented long-short equity strategy that focuses on reducing volatility and preserving capital. In normal times, the fund's net stock exposure typically will range between 50% and 70% but can fall as low as 10%. Management relies on a systematic drawdown process to reduce the fund's exposure when losses reach certain thresholds.

The fund invests in primarily U.S. stocks of all capitalizations. The long positions are the analysts' best ideas from River Road Asset Management's long-only portfolios, while the short positions are selected by the two portfolio managers, Matt Moran and Daniel Johnson. Generally, the long side of the portfolio has between 15 and 30 names, while the short side is more diversified, with 20 to 40 positions. As of June 30, 2012, the fund held 30 long and 40 short positions with a 50% net equity exposure (139% gross). The largest long net sector exposure was information technology (13.6%), and the largest net short sector exposure was materials (2.6%).

Process
Starting with an initial universe of 200 to 300 equities covered by the firm, management selects the highest-conviction names, relying on other River Road funds and their teams of analysts. Long positions tend to be stocks of companies with predictable, sustainable business models that generate significant free cash flow; shareholder-friendly management; and discounts of at least 25% to the analysts' assessed fundamental values. The team looks at break-up values for asset-heavy companies. For example, since the fund's inception, management has believed that Madison Square Garden **MSG** was substantially undervalued because of its air rights above the property.

The short selection process is very similar, but with a few caveats. Though management seeks overvalued companies (trading at a 20% premium), it will avoid names with strong, positive momentum. Management promptly exits positions when they reach fair value. Management also does not buy more of a stock when it drops in price, and it will not short securities if it can't find able opportunities.

Risk Management
Management relies on a systematic drawdown process that diminishes the fund's exposure according to certain market trigger points. If cumulative fund losses, tracked at the day's closing, reach 4%, 6%, or 8%, the fund's maximum exposure is reduced to 50%, 30%, and 10%, respectively. Management also has discretion to initiate the drawdown plan intraday.

While it's easy to plan on cutting losses, it's more difficult to determine when to put the risk back on as market conditions improve. In order to avoid missing market upswings, this fund relies on a clear-cut process to relever the fund. When the Russell 3000 50-day moving average turns positive, this fund moves to a minimum net market exposure of 30%. When the moving average is positive for 10 days, management will move the fund's exposure to at least 50%.

Release date 08-31-2012

ASTON/River Road Long-Short N (USD)

Standard Index	Category Index	Morningstar Cat
S&P 500 TR	Russell 1000 TR USD	US OE Long/Short Equity

Performance 08-31-2012

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2010	—	—	—	—	—
2011	—	—	-4.48	3.96	—
2012	5.41	-0.76	—	—	6.41

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	10.28	—	—	—	4.95
Std 06-30-2012	3.88	—	—	—	4.15
Total Return	10.28	—	—	—	4.95
+/- Std Index	-7.72	—	—	—	—
+/- Cat Index	-7.05	—	—	—	—
% Rank Cat	13	—	—	—	
No. in Cat	178	—	—	—	
7-day Yield	0.00				

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 800-992-8151 or visit www.astonfunds.com.

Fees and Expenses

Sales Charges

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

Fund Expenses

Management Fees %	1.20
12b1 Expense %	0.25
Gross Expense Ratio %	**8.70**

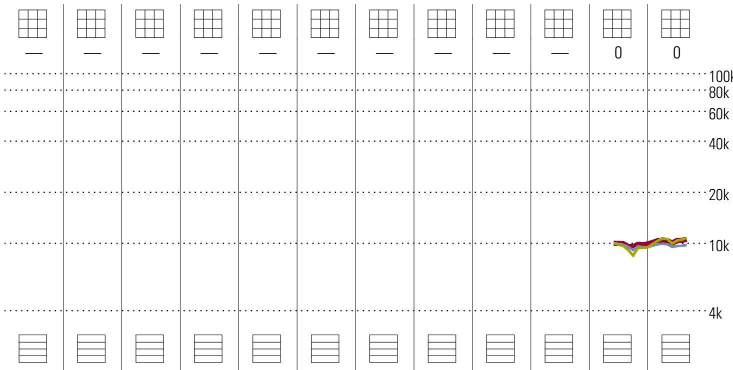
Risk and Return Profile

	3 Yr *87 funds*	5 Yr *56 funds*	10 Yr *19 funds*
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	5.08%



Investment Style
Fixed-Income
Bond %

Growth of $10,000
ASTON/River Road Long-Short N
10,546
Category Average
9,769
Standard Index
10,750

Performance Quartile
(within category)

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	08-12	History
—	—	—	—	—	—	—	—	—	—	9.98	10.62	NAV/Price
—	—	—	—	—	—	—	—	—	—	—	6.41	Total Return %
—	—	—	—	—	—	—	—	—	—	—	-7.10	+/- Standard Index
—	—	—	—	—	—	—	—	—	—	—	-6.95	+/- Category Index
—	—	—	—	—	—	—	—	—	—	—	—	% Rank Cat
—	—	—	—	—	—	—	—	—	—	—	199	No. of Funds in Cat

Portfolio Analysis 06-30-2012

Asset Allocation %	Net %	Long %	Short %
Cash	50.64	53.23	2.59
US Stocks	48.28	87.47	39.19
Non-US Stocks	3.47	4.10	0.63
Bonds	-0.30	0.00	0.30
Other/Not Clsfd	-2.09	0.00	2.09
Total	100.00	144.80	44.80

Equity Style (Value Blend Growth; Large Mid Small)

Portfolio Statistics	Port Avg	Rel Index	Rel Cat
P/E Ratio TTM	13.7	0.91	1.00
P/C Ratio TTM	8.1	0.89	0.91
P/B Ratio TTM	1.7	0.79	0.82
Geo Avg Mkt Cap $mil	11398	0.20	0.33

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	100.0	1.01
Greater Europe	0.0	0.00
Greater Asia	0.0	—

Share Chg since 03-2012	Share Amount	Holdings: 545 Total Stocks , 7 Total Fixed-Income, 127% Turnover Ratio	% Net Assets
☼	7,201	SPDR S&P 500	-15.72
⊕	9,143	Molson Coors Brewing Company	6.09
⊕	3,677	Berkshire Hathaway Inc Class B	4.91
⊕	7,332	Loews Corporation	4.80
☼	6,868	Expeditors International of Washin	4.26
⊕	15,231	Western Union Company	4.11
⊕	9,002	Thomson Reuters Corporation	4.10
⊕	7,743	Hill-Rom Holdings, Inc.	3.83
⊕	12,664	Liberty Interactive Corp Class A	3.61
⊕	3,958	DST Systems, Inc.	3.44
⊕	2,752	Becton Dickinson & Co	3.29
☼	6,453	Oracle Corporation	3.07
☼	2,685	Dun & Bradstreet Corporation	3.06
⊖	5,017	Madison Square Garden Co	3.01
⊕	692	CME Group, Inc. Class A	2.97

Sector Weightings	Stocks %	Rel Std Index
Cyclical	**41.2**	**1.50**
Basic Materials	0.0	0.00
Consumer Cyclical	16.8	1.74
Financial Services	24.4	1.85
Real Estate	0.0	0.00
Sensitive	**34.4**	**0.75**
Communication Services	0.0	0.00
Energy	6.3	0.56
Industrials	21.6	1.92
Technology	6.6	0.35
Defensive	**24.4**	**0.91**
Consumer Defensive	13.9	1.18
Healthcare	7.8	0.67
Utilities	2.7	0.79

Operations

Family:	Aston	Ticker:	ARLSX	Incept:	05-04-2011
Manager:	Multiple	Minimum Initial Purchase:	$2,500	Type:	MF
Tenure:	1.3 Years	Min Auto Investment Plan:	$2,500	Total Assets:	$7.51 mil
Objective:	Growth and Income	Minimum IRA Purchase:	$500		
Base Currency:	USD	Purchase Constraints:	—		

MORNINGSTAR®

Fund Reports

Credit Suisse Multialternative Strategy

by **Terry Tian**

Advisor
Credit Suisse Asset Management LLC

Advisor Location
New York, New York

Assets Under Management
$6.1 million (fund)

Inception Date
March 30, 2012

Investment Type
Mutual fund

Morningstar Category
Multialternative

Management
The fund is managed by Jordan Drachman, Sheel Dhande, and Alexander De Feo. Drachman and Dhande focus on the development and adjustment of the fund's trading models. De Feo takes charge of the trading execution. Prior to joining Credit Suisse in 2007, Drachman worked for Bank of America Securities where he developed option-strategy trading models. He received his Ph.D. in mathematics from Stanford University. Dhande used to work in the quantitative portfolio strategies group in the fixed-income division of Lehman Brothers. Prior to Credit Suisse, De Feo was responsible for allocation and hedge fund research at Bank of America.

Strategy

The fund attempts to replicate the returns and volatility of the Dow Jones Credit Suisse Hedge Fund Index, an asset-weighted broad hedge fund index with approximately 450 hedge funds, currently representing about $650 billion in assets. The minimum AUM and track record for a hedge fund to be included in the index is $50 million and one year, respectively. Management breaks down the hedge fund universe into three groups of strategies, namely, long-short equity, event-driven, and global (such as managed futures and global macro), in order to identify risk factors to replicate. The risk factors are represented by either index futures or options (for the S&P 500 Index factor, for example) or baskets of securities (to represent merger arbitrage, for example).

The team uses 10 risk factors to replicate the long/short equity strategy (such as the S&P 500 and MSCI Emerging Market Indexes), six factors for the event-driven strategy (the Russell 2000 and merger arbitrage securities), and seven for the global strategies (currency carry and managed futures, for example). The managed-futures factor is a diversified trend-following strategy trading 18 futures markets and using three- to 18-month momentum signals. The currency carry factor takes positions in nine foreign-currency forward contracts.

Process

The fund employs different replication approaches for each of the three strategy groups. In the long/short equity sleeve, management regresses the last 12 monthly returns of the Dow Jones Credit Suisse Long/Short Equity Hedge Fund Index against five market exposure factors (S&P 500, MSCI Emerging Markets, for example) and four style factors (Russell 2000 Value and Growth Indexes and equity momentum factors). The unexplained residual is then regressed against nine S&P 500 sector factors using the last six months of returns. In the event-driven sleeve, management regresses the Dow Jones Credit Suisse Event Driven Hedge Fund Index against six factors (such as IBOXX High Yield and Russell 2000 Indexes) using the last 12 months of data.

In the global strategies sleeve, management creates an index of eight different Dow Jones Credit Suisse hedge fund strategy indexes (such as the managed-futures and global macro indexes). The weight of the managed-futures factor is determined by the weight of managed-futures strategies in the overall index. The remaining factor weightings are determined by a regression of the index against four other groups of factors (euro/U.S. dollar, an emerging-markets currencies basket, and the long/short equity and event-driven factors noted above) using a 24-month time frame. Management then uses three additional factors (currency carry, managed futures, and an S&P 500 put-write strategy) to match the volatility of the unexplained residual. The three broad strategy allocations are rebalanced monthly. Management adds or deletes factors as needed.

Risk Management

Management monitors the fund's market and asset-class exposures, tracking errors, liquidity (the fund targets 100% daily liquidity), and correlation (the fund aims to achieve an annualized 0.80–0.85 correlation to the Dow Jones Credit Suisse Hedge Fund Index) on a regular basis. A separate risk-management team stress-tests the portfolio on various risk factors (for example, an equity market meltdown).

Release date 09-30-2012

Credit Suisse Multialternative Strat A (USD)

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

Performance 09-30-2012

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2010	—	—	—	—	—
2011	—	—	—	—	—
2012	—	-1.30	1.62	—	—

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	—	—	—	—	-4.97
Std 09-30-2012	—	—	—	—	-4.97
Total Return	—	—	—	—	0.30
+/- 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 877-870-2874 or visit www.credit-suisse.com/us.

Fees and Expenses

Sales Charges

Front-End Load %	**5.25**
Deferred Load %	**NA**

Fund Expenses

Management Fees %	1.15
12b1 Expense %	0.25
Gross Expense Ratio %	**3.38**

Risk and Return Profile

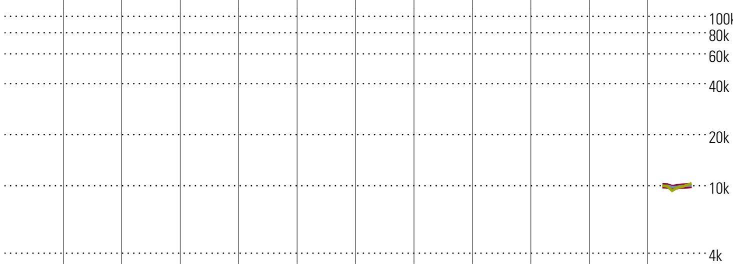
	3 Yr *118 funds*	5 Yr *40 funds*	10 Yr *5 funds*
Morningstar Rating™	—	—	—
Morningstar Risk	—	—	—
Morningstar Return	—	—	—

	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

- Credit Suisse Multialternative Strat A 10,030
- Category Average 10,060
- Standard Index 10,343

Performance Quartile (within category)

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	09-12	History
—	—	—	—	—	—	—	—	—	—	—	10.03	NAV/Price
—	—	—	—	—	—	—	—	—	—	—	—	Total Return %
—	—	—	—	—	—	—	—	—	—	—	—	+/- Standard Index
—	—	—	—	—	—	—	—	—	—	—	—	+/- Category Index
—	—	—	—	—	—	—	—	—	—	—	—	% Rank Cat
—	—	—	—	—	—	—	—	—	—	—	—	No. of Funds in Cat

Portfolio Analysis

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

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	—	—

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

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:	Credit Suisse (New York, NY)	Ticker:	CSQAX	Incept:	03-30-2012
Manager:	Multiple	Minimum Initial Purchase:	$2,500	Type:	MF
Tenure:	0.6 Year	Min Auto Investment Plan:	$50	Total Assets:	$6.13 mil
Objective:	Growth and Income	Minimum IRA Purchase:	$500		
Base Currency:	USD	Purchase Constraints:	—		

MORNINGSTAR®

Fund Reports

Guggenheim Multi-Hedge Strategies

by **Terry Tian**

Advisor
Security Investors LLC (Guggenheim Investments)

Advisor Location
New York, New York

Assets Under Management
$143 million (fund)

Inception Date
Sept. 19, 2005

Investment Type
Mutual fund

Morningstar Category
Multialternative

Management
This fund is managed by a team from Rydex Investments, which was acquired by Guggenheim Investments in 2010. Portfolio managers Michael Dellapa and Larry Shank designed the fund's investment strategies and developed the trading models. Prior to joining Rydex, Dellapa worked as an equity analyst for Invista Capital and as a systems analyst for Accenture. Shank has been an analyst with Rydex since 2001 and was promoted to portfolio manager in 2007. Michael Byrum, CIO of Rydex Investments, and Ryan Harder, lead portfolio manager for indexed strategies at Rydex, oversee this fund's research process. The managers are supported by a team of four analysts and six traders.

Strategy
This fund was first launched as a hedge fund replication strategy in 2005. Management altered the strategy in September 2009 in order to control its rising correlation to the stock market. Developed and run by managers Michael Dellapa and Larry Shank, the fund now employs five buckets of primarily systematic alternative strategies: merger arbitrage, equity market-neutral (which includes a quantitative stock-selection strategy and a closed-end fund arbitrage strategy), equity market-momentum (which attempts to exploit country, sector, and size momentum in equity markets), global macro (which includes volatility arbitrage and managed-futures strategies), and fixed-income arbitrage (which includes a Treasury flattener and a credit-spread arbitrage strategy). Management dynamically adjusts allocations to each strategy to capture market opportunity. The fund targets an annualized correlation to the stock market (as represented by the S&P 500 Index) between 0.3 and 0.6, a Sharpe ratio above 0.6, and an annualized volatility of 5% to 8%. Management typically makes one significant update to the trading models every six months based on continuous research.

Process
Management builds each alternative strategy from the bottom up. Originally, management equally risk-weighted all strategies, but now dynamically adjusts the weights every six weeks based on quantitative models (optimized on correlation, volatility, and Sharpe ratio, for example) and management's judgment of the current market environment (the number of merger deals and volatility levels, for example).

In the equity momentum bucket, management identifies price trends across countries, industries, and market capitalizations, and uses exchange-traded funds (for countries), baskets of stocks (for industries), or index futures (for market capitalization). In the merger-arbitrage sleeve, the fund typically invests in 30 to 40 U.S. domestic deals with market capitalizations greater than $200 million. The quantitative equity market-neutral model takes long and short positions in stocks in the Russell 1000 based on valuation, growth, and momentum factors. In the closed-end fund arbitrage strategy, management takes long positions in baskets of discounted CEFs (betting on a tightening of the discount) and hedges by shorting a basket of ETFs that track the CEFs' market exposures.
In the global macro sleeve, management takes long or short positions in VIX futures and employs both price-trend following and mean-reversion strategies in commodity futures only. Lastly, in the fixed-income arbitrage sleeve, the fund bets on the Treasury yield-curve flattening (long the 10-year Treasury futures and short the two-year) and/or credit default swap spreads (widening or narrowing).

Risk Management
The fund employs risk management on both the individual strategy and fund levels. For example, in the merger-arbitrage sleeve, management limits each deal's potential loss to 1% of the capital allocated to the merger-arbitrage strategy. In the managed-futures sleeve, management incorporates volatility to determine position size. For example, more-volatile commodities (such as silver) receive smaller full-position sizes (for strong price trends) than less-volatile commodities (such as cattle). On the portfolio level, management monitors risk contribution from each strategy and adjusts strategy allocation to avoid concentration risk. A separate committee reviews counterparty risk on a quarterly basis for all derivatives the fund trades.

Release date 08-31-2012

Guggenheim Multi-Hedge Strategies A (USD)

Overall Morningstar Rtg™	Standard Index	Category Index	Morningstar Cat
★★ 118 US OE Multialternative	S&P 500 TR	Barclays US Agg Bond TR USD	US OE Multialternative

Performance 08-31-2012

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2010	-0.39	-2.88	5.83	2.85	5.30
2011	1.02	1.42	1.58	-0.65	3.39
2012	0.85	-0.18	—	—	1.80

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	-2.19	2.24	-3.14	—	-1.04
Std 06-30-2012	-3.23	—	-3.94	—	-1.22
Total Return	2.69	3.91	-2.20	—	-0.34
+/- Std Index	-15.31	-9.72	-3.47	—	—
+/- Cat Index	-3.09	-2.60	-8.86	—	—
% Rank Cat	41	47	79	—	
No. in Cat	193	118	40	—	
7-day Yield	0.00				

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 800-820-0888 or visit www.rydex-sgi.com.

Fees and Expenses

Sales Charges

Front-End Load %	**4.75**
Deferred Load %	**NA**

Fund Expenses

Management Fees %	1.28
12b1 Expense %	0.25
Gross Expense Ratio %	**2.93**

Risk and Return Profile

	3 Yr 118 funds	5 Yr 40 funds	10 Yr 4 funds
Morningstar Rating™	3★	2★	—
Morningstar Risk	Low	-Avg	—
Morningstar Return	Avg	Low	—

	3 Yr	5 Yr	10 Yr
Standard Deviation	3.67	7.89	—
Mean	3.91	-2.20	—
Sharpe Ratio	1.04	-0.32	—

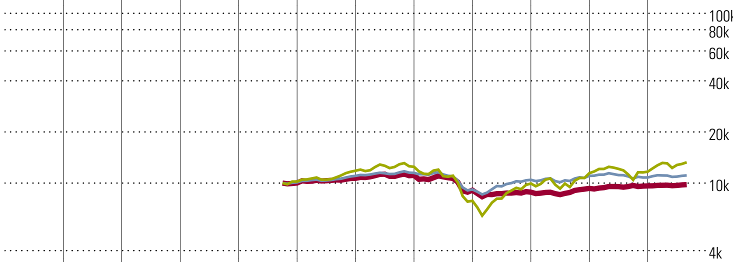
MPT Statistics	Standard Index	Best Fit Index DJ US Telecom TR USD
Alpha	2.52	1.24
Beta	0.09	0.15
R-Squared	15.50	34.13

12-Month Yield	—
30-day SEC Yield	—
Potential Cap Gains Exp	-42.97%

Investment Style
Equity
Stock %

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	08-12
—	—	—	—	52	39	38	35	74	58	39	42

Growth of $10,000
Guggenheim Multi-Hedge Strategies A
9,794
Category Average
11,095
Standard Index
13,251



Performance Quartile
(within category)

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	08-12	History
—	—	—	—	24.89	25.92	26.05	21.12	20.57	21.66	22.23	22.63	NAV/Price
—	—	—	—	—	6.60	3.96	-18.22	-2.60	5.30	3.39	1.80	Total Return %
—	—	—	—	—	-9.20	-1.53	18.78	-29.07	-9.76	1.28	-11.71	+/- Standard Index
—	—	—	—	—	2.27	-3.00	-23.46	-8.53	-1.24	-4.45	-2.05	+/- Category Index
—	—	—	—	—	69	57	21	97	43	2	—	% Rank Cat
—	—	—	—	—	24	41	63	105	140	175	217	No. of Funds in Cat

Portfolio Analysis 08-31-2012

Asset Allocation %	Net %	Long %	Short %
Cash	82.95	83.06	0.11
US Stocks	15.00	53.26	38.26
Non-US Stocks	5.01	9.87	4.86
Bonds	-0.15	1.99	2.14
Other/Not Clsfd	-2.82	0.69	3.51
Total	100.00	148.88	48.88

Equity Style
Value Blend Growth
Large Mid Small

Portfolio Statistics	Port Avg	Rel Index	Rel Cat
P/E Ratio TTM	14.4	0.97	1.02
P/C Ratio TTM	8.6	0.95	1.04
P/B Ratio TTM	1.8	0.83	0.98
Geo Avg Mkt Cap $mil	7177	0.13	0.47

Fixed-Income Style
Ltd Mod Ext
High Med Low

Avg Eff Maturity	—
Avg Eff Duration	—
Avg Wtd Coupon	3.43
Avg Wtd Price	116.34

Credit Quality Breakdown 03-31-2012	Bond %
AAA	45.68
AA	2.86
A	10.91
BBB	17.67
BB	11.97
B	6.13
Below B	1.48
NR/NA	3.30

Regional Exposure	Stock %	Rel Std Index
Americas	91.6	0.92
Greater Europe	4.8	5.89
Greater Asia	3.6	—

Share Chg since 07-2012	Share Amount	Holdings: 5,636 Total Stocks , 2,764 Total Fixed-Income, 433% Turnover Ratio	% Net Assets
	285,812	Cfc Multi Hedge Strategies	3.86
⊖	58,509	iShares Russell 1000 Value Index	-2.87
⊖	48,761	iShares Russell 1000 Growth Index	-2.24
⊕	69,346	Ariba, Inc.	2.16
⊕	100,080	Interline Brands Inc	1.77
⊕	108,229	Collective Brands, Inc.	1.63
⊕	26,999	Cooper Industries PLC.	1.38
⊖	22,296	iShares Russell 2000 Index	-1.26
⊕	18,015	Amerigroup Corporation	1.14
⊖	11,585	SPDR S&P 500	-1.14
⊕	268	Cboe Vix Future Sep12	-1.14
☼	29,682	Par Pharmaceutical Companies, Inc.	1.03
⊕	28,637	LyondellBasell Industries NV	0.97
⊕	10,648	iShares Barclays Aggregate Bond	-0.83
⊖	54,141	India Fund	0.80

Sector Weightings	Stocks %	Rel Std Index
Cyclical	**34.2**	**1.24**
Basic Materials	5.4	1.98
Consumer Cyclical	12.5	1.29
Financial Services	12.8	0.97
Real Estate	3.5	1.78
Sensitive	**41.2**	**0.90**
Communication Services	2.8	0.64
Energy	5.3	0.48
Industrials	14.6	1.30
Technology	18.4	0.98
Defensive	**24.6**	**0.92**
Consumer Defensive	7.2	0.61
Healthcare	12.2	1.05
Utilities	5.2	1.51

Operations

Family:	Guggenheim Investments	Base Currency:	USD	Purchase Constraints:	—
Manager:	Multiple	Ticker:	RYMQX	Incept:	09-19-2005
Tenure:	6.1 Years	Minimum Initial Purchase:	$2,500	Type:	MF
Objective:	Growth	Minimum IRA Purchase:	$1,000	Total Assets:	$143.08 mil

Fund Reports

Ladenburg Thalmann Alternative Strategies

by **Mallory Horejs**

Advisor
Ladenburg Thalmann Asset Management

Advisor Location
New York, New York

Assets Under Management
$19.4 million

Inception Date
Sept. 28, 2010

Investment Type
Closed-end fund

Morningstar Category
Multialternative

Management
Philip Blancato, president and chief investment officer of Ladenburg Thalmann Asset Management, runs this closed-end interval fund. Prior to joining Ladenburg in 2004, Blancato spent 12 years at Prudential Securities in the firm's investment-management division. Blancato is supported by two investment research analysts and one full-time trader, all of whom sit on Ladenburg Thalmann's investment-policy committee. The firm's chief operating officer, Jaime Desmond, also sits on the committee. Ladenburg Thalmann Asset Management, a subsidiary of Ladenburg Thalmann Financial Services, is an investment advisory firm with $1.2 billion in assets under management.

Strategy
This closed-end interval fund of funds invests in a diversified portfolio of publicly traded and private alternative products and focuses on income generation. The portfolio spans nearly 10 alternative asset classes, including real estate (traded and nontraded equity and mortgage REITs), master limited partnerships (individual and closed-end funds of MLPs), managed-futures funds, and business-development companies (traded and nontraded), among others. Allocations are flexible, but the fund typically invests at least 25% of its assets in real estate securities. Roughly 60% to 70% of the portfolio consists of publicly traded securities, while nontraded funds account for 30% to 40% of portfolio assets. As of June 2012, the fund held 25 underlying investments, with the three largest positions all being nontraded REITs: Hines Global REIT (9%), Steadfast Income REIT (5%), and Strategic Storage Trust REIT (5%). Management intends for investments to be long-term and expects annual turnover to be around 10%. The team targets a 6% annual distribution, paid quarterly. The fund may employ leverage of up to 33% of fund assets.

Process
This fund's investment process is top-down rather than company-driven. Management first determines which alternative investment types are most attractive (typically those exhibiting lower correlation to the S&P 500 with lower volatility) and then identifies the best securities for investment through bottom-up analysis. For both private and public investments, manager Philip Blancato looks for companies exhibiting attractive earnings, high dividends, low volatility, and relatively low correlation to the broad markets. For publicly traded securities, the due diligence process is done completely in-house—Blancato and his analysts construct proprietary earnings models using public filings and company information, speak with independent industry analysts covering the security, and interview management teams. Because private investments carry additional risks, Blancato utilizes a third-party advisor, ButtonWood Advisors, for additional due diligence. Blancato then selects which investments to conduct further internal due diligence on. Before investing, the team looks at the product's overall fit into and impact on the existing portfolio and will define reasonable targets (Sharpe ratio, standard deviation, etc.) for ongoing analysis.

Risk Management
This fund's most significant risks are return of capital and illiquidity. If the cash flows of the fund's underlying investment fall short of the fund's target quarterly/annual distribution, the fund may use cash reserves, leverage, or sell securities to return cash to investors. In terms of illiquidity risk, though interval funds are legally classified as closed-end funds, their shares do not typically trade on the secondary market. This fund instead provides limited liquidity through quarterly repurchase offers, at net asset value, of up to 5% of the shares outstanding. There is no guarantee that shareholders will be able to sell all the shares they desire in a quarterly repurchase offer, however. Management monitors liquidity risk in several ways. First, it adheres to strict position size limits—allocations to underlying funds rarely exceed 5%. Second, should a security experience a 5% price decline, management will reassess the position. Once the losses reach 20%, Blancato will exit the position completely. Finally, management relies on its third-party consultant, ButtonWood Advisors, and administrator, Gemini Fund Services, for additional help in valuing the portfolio's nontraded products. Management does not currently hedge any portfolio-level risks.

Release date 08-31-2012

Ladenburg Thalmann Alt Strategies (USD)

Overall Morningstar Rtg™	Standard Index	Category Index	Morningstar Cat
— Multialternative	S&P 500 TR	Barclays US Agg Bond TR USD	Multialternative

Performance 08-31-2012

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2010	—	—	—	0.86	—
2011	2.42	0.20	-5.47	5.03	1.89
2012	4.09	0.81	—	—	6.39

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Std Mkt 06-30-12	—	—	—	—	—
Std NAV 06-30-12	4.17	—	—	—	4.39
Mkt Total Ret	—	—	—	—	—
NAV Total Ret	8.88	—	—	—	4.75
+/- Std Index	-9.12	—	—	—	—
+/- Cat Index	3.10	—	—	—	—
% Rank Cat	—	—	—	—	
No. in Cat	—	—	—	—	

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 877-803-6583.

Fees and Expenses

Fund Expenses

Management Fees %	0.75
Expense Ratio %	4.36
12b1 Expense %	NA

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	—	—	—

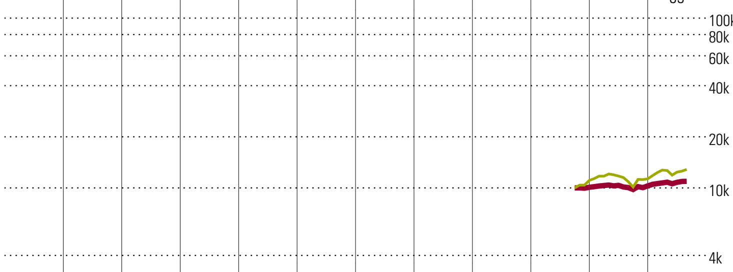
MPT Statistics NAV	Standard Index	Best Fit Index
Alpha	—	—
Beta	—	—
R-Squared	—	—

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

Investment Style
Equity
Stock %

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	08-12
—	—	—	—	—	—	—	—	—	—	—	69

Growth of $10,000
Ladenburg Thalmann Alt Strategies 10,934
Standard Index 12,837



Performance Quartile (within category)

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	08-12	History
—	—	—	—	—	—	—	—	—	—	—	—	Mkt Total Ret %
—	—	—	—	—	—	—	—	—	—	1.89	6.39	NAV Total Ret %
—	—	—	—	—	—	—	—	—	—	-0.22	-7.12	+/- Standard Index
—	—	—	—	—	—	—	—	—	—	-5.95	2.54	+/- Category Index
—	—	—	—	—	—	—	—	—	—	—	—	% Rank Cat
—	—	—	—	—	—	—	—	—	—	—	—	No. of Funds in Cat
—	—	—	—	—	—	—	—	—	—	—	—	Avg Prem/Discount %

Portfolio Analysis 08-31-2012

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

Equity Style
Value Blend Growth
Large Mid Small

Portfolio Statistics	Port Avg	Rel Index	Rel Cat
P/E Ratio TTM	15.0	1.00	1.06
P/C Ratio TTM	—	—	—
P/B Ratio TTM	1.5	0.69	2.64
Geo Avg Mkt Cap $mil	3205	0.06	0.21

Fixed-Income Style
Ltd Mod Ext
High Med Low

Avg Eff Maturity	5.07
Avg Eff Duration	3.96
Avg Wtd Coupon	7.96
Avg Wtd Price	108.91

Credit Quality Breakdown —	Bond %
AAA	0.00
AA	0.00
A	0.00
BBB	4.79
BB	38.18
B	42.00
Below B	14.83
NR/NA	0.20

Regional Exposure	Stock %	Rel Std Index
Americas	98.4	0.99
Greater Europe	1.6	1.97
Greater Asia	0.0	—

Share Chg since	Share Amount	Holdings: 0 Total Stocks , 0 Total Fixed-Income, 14% Turnover Ratio	% Net Assets
—			

Sector Weightings	Stocks %	Rel Std Index
Cyclical	**50.4**	**1.83**
Basic Materials	0.8	0.29
Consumer Cyclical	0.0	0.00
Financial Services	19.3	1.46
Real Estate	30.4	15.52
Sensitive	**48.9**	**1.07**
Communication Services	0.0	0.00
Energy	46.0	4.11
Industrials	2.9	0.26
Technology	0.0	0.00
Defensive	**0.6**	**0.02**
Consumer Defensive	0.0	0.00
Healthcare	0.0	0.00
Utilities	0.6	0.19

Operations

Family:	Ladenburg Thalmann	Ticker:	LTAFX	Prem/Discount:	—
Manager:	Philip Blancato	Incept:	09-28-2010	Mkt Price:	—
Tenure:	2.0 Years	Exchange:	—	Base Currency:	USD
Total Assets:	$19.4 mil	NAV:	10.15		

Fund Reports

RiverPark Long/Short Opportunity

by **Mallory Horejs**

Advisor
RiverPark Advisors, LLC

Advisor Location
New York, New York

Assets Under Management
$24.3 million (fund)

Inception Date
March 30, 2012 (mutual fund)

Investment Type
Mutual fund

Morningstar Category
Long-short equity

Management
Portfolio managers Mitch Rubin and Conrad van Tienhoven have run this long-short equity strategy in hedge fund format since Oct. 1, 2009. It was converted into an open-end mutual fund on March 30, 2012. Rubin and van Tienhoven are supported by three analysts: Oliver Prichard (qualitative research), Gary Schnierow (quantitative analysis and financial modeling), and Elizabeth Schaja (macroeconomic research). Traders Kristi Caruso and William Chang round out the team. The fund's advisor, RiverPark Advisors, was founded by Morty Schaja, Rubin, van Tienhoven, and Caruso in March 2006. The four previously worked together at Baron Capital for more than 15 years.

Strategy

This concentrated long-short equity fund invests around broad secular themes. Management looks for macroeconomic trends and then analyzes which industries and companies are most significantly impacted, both positively and negatively. The team purchases equity securities that it believes have above-average growth prospects and sells short equity securities that it believes are competitively disadvantaged over the long term. Management takes roughly 40–60 individual long positions and 40–75 short securities. (As of June 30, 2012, the portfolio held 57 long and 56 short positions.) Relative to other long-short equity offerings, RiverPark maintains a relatively concentrated portfolio, with roughly 30% of assets concentrated in the fund's top 10 holdings. As of June 30, 2012, the fund's net equity exposure was 41%, well within management's target range of 20%–70%. The portfolio's largest net sector exposures were: information technology (17.7%), financials (14.7%), and industrials (9.6%). The top three individual long positions were Blackstone Group LP **BX** (4.7% of assets), Google **GOOG** (3.4%), and Apple **AAPL** (3.4%).

Process

Portfolio manager Mitch Rubin begins the research process by identifying the most significant secular trends affecting the economy (aging population and digitization of content/information, for example). Next, the team examines which industries and sectors are being most affected by these themes. Then, the management team conducts market-level research (size and growth of the market, competitive advantages and barriers to entry, as well as pricing patterns) and financial analysis (revenue trends, incremental margins, returns on equity and returns on invested capital, and excess cash flow) to identify individual securities for potential long and short positions.
Rubin assesses the quality of each company's management team through interviews, site visits, and conversations with employees, customers, and competitors. Management typically meets with smaller portfolio companies once or twice per year and bigger companies more frequently.
During the final stage, investment, valuation is carefully considered. Entry and exit points are timed based on price targets from the team's financial models.

Risk Management

Management views its portfolio-diversification requirements and its exposure constraints as its primary risk-management tools. Rubin constructs the portfolio based on five to 10 investment themes at all times, with each theme representing no more than 30% gross/15% net exposure.
Aggregate industry-level exposure is limited to 20% gross/10% net. Long positions are initially capped at 5% (at cost) and market value cannot exceed 10% of portfolio assets. Short positions are always limited to 3% of assets. Management does not adhere to any volatility constraints, beta ranges, or stop-loss measures, and it does not routinely hedge aggregate equity or currency exposure. The team will use derivatives, though (selling covered calls or shorting puts instead of buying the stock, for example), to generate extra return when management deems the risk/reward trade-off attractive. The portfolio is subject to an independent review by RiverPark COO Morty Schaja and other members of the operations team on a daily basis.

Release date 08-31-2012

RiverPark Long/Short Opportunity Instl (USD)

Standard Index	Category Index	Morningstar Cat
S&P 500 TR	Russell 1000 TR USD	US OE Long/Short Equity

Performance 08-31-2012

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2010	-1.63	-6.25	9.26	3.87	4.65
2011	4.62	1.16	-4.89	7.77	8.48
2012	21.05	-3.60	—	—	20.81

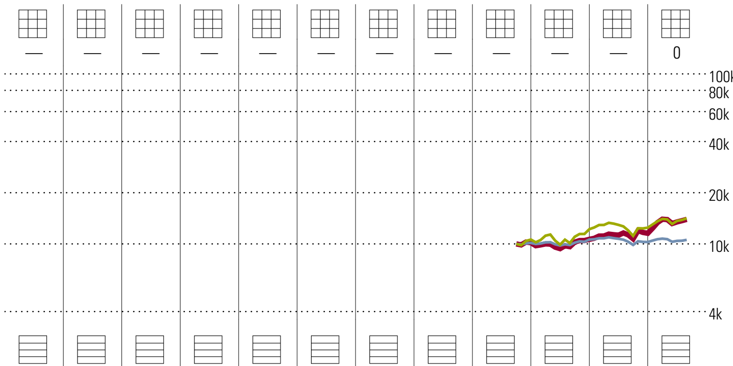
Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	23.43	—	—	—	12.06
Std 06-30-2012	19.61	—	—	—	11.44
Total Return	23.43	—	—	—	12.06
+/- Std Index	5.43	—	—	—	—
+/- Cat Index	6.10	—	—	—	—
% Rank Cat	—	—	—	—	
No. in Cat	—	—	—	—	
7-day Yield	0.00				

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 888-564-4517 or visit www.riverparkfunds.com.



Investment Style
Fixed-Income
Bond %

Growth of $10,000
RiverPark Long/Short Opportunity Instl 13,941
Category Average 10,563
Standard Index 14,142

Performance Quartile
(within category)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	08-12	History
	—	—	—	—	—	—	—	—	7.28	7.62	8.26	9.98	NAV/Price
	—	—	—	—	—	—	—	—	—	4.65	8.48	20.81	Total Return %
	—	—	—	—	—	—	—	—	—	-10.41	6.37	7.30	+/- Standard Index
	—	—	—	—	—	—	—	—	—	-11.44	6.98	7.44	+/- Category Index
	—	—	—	—	—	—	—	—	—	—	—	—	% Rank Cat
	—	—	—	—	—	—	—	—	—	—	—	—	No. of Funds in Cat

Portfolio Analysis 08-31-2012

Asset Allocation %	Net %	Long %	Short %
Cash	51.19	51.19	0.00
US Stocks	55.31	105.71	50.39
Non-US Stocks	-1.77	2.81	4.58
Bonds	0.00	0.00	0.00
Other/Not Clsfd	-4.74	0.06	4.79
Total	100.00	159.76	59.76

Equity Style (Value / Blend / Growth; Large / Mid / Small)

Portfolio Statistics	Port Avg	Rel Index	Rel Cat
P/E Ratio TTM	20.8	1.39	1.52
P/C Ratio TTM	14.2	1.57	1.60
P/B Ratio TTM	3.1	1.46	1.53
Geo Avg Mkt Cap $mil	15413	0.27	0.44

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	100.0	1.01
Greater Europe	0.0	0.00
Greater Asia	0.0	—

Share Chg since 07-2012	Share Amount	Holdings: 141 Total Stocks , 0 Total Fixed-Income, — Turnover Ratio	% Net Assets
⊕	1,712	Apple, Inc.	4.99
⊕	1,560	Google, Inc. Class A	4.68
⊕	78,070	Blackstone Group LP	4.61
⊕	16,241	Qualcomm, Inc.	4.37
⊕	12,480	Coach, Inc.	3.18
⊕	16,580	Las Vegas Sands Corp	3.08
⊕	1,136	Priceline.com, Inc.	3.01
⊕	13,767	Starbucks Corporation	2.99
⊕	13,846	Dollar Tree Stores, Inc.	2.92
⊕	10,150	Cognizant Technology Solutions Cor	2.86
⊕	3,286	Equinix, Inc.	2.85
⊕	37,390	Bankrate Inc	2.81
⊕	12,892	eBay Inc	2.68
⊕	6,860	Monsanto Company	2.62
⊕	21,382	EMC Corporation	2.46

Sector Weightings	Stocks %	Rel Std Index
Cyclical	**51.5**	**1.87**
Basic Materials	3.5	1.28
Consumer Cyclical	31.0	3.21
Financial Services	16.9	1.29
Real Estate	0.0	0.00
Sensitive	**42.7**	**0.94**
Communication Services	6.1	1.38
Energy	6.9	0.62
Industrials	6.3	0.56
Technology	23.5	1.25
Defensive	**5.8**	**0.22**
Consumer Defensive	4.1	0.35
Healthcare	1.8	0.15
Utilities	0.0	0.00

Fees and Expenses

Sales Charges

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

Fund Expenses

Management Fees %	1.50
12b1 Expense %	NA
Gross Expense Ratio %	**3.75**

Risk and Return Profile

	3 Yr *87 funds*	5 Yr *56 funds*	10 Yr *19 funds*
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	—	—

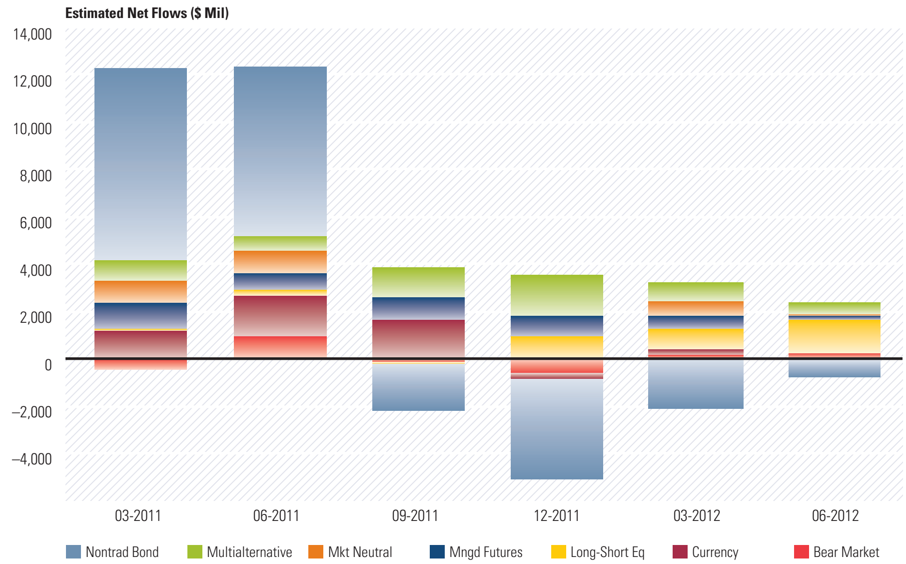
12-Month Yield	—
30-day SEC Yield	—
Potential Cap Gains Exp	—

Operations

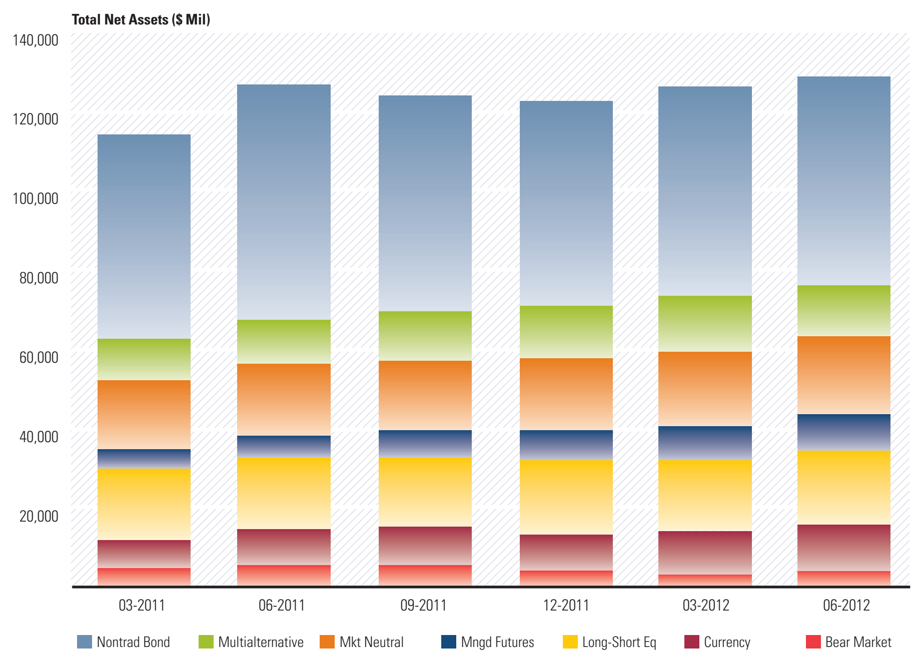
Family:	River Park Funds	Base Currency:	USD	Incept:	09-30-2009
Manager:	Mitchell Rubin	Ticker:	RLSIX	Type:	MF
Tenure:	0.5 Year	Minimum Initial Purchase:	$1 mil	Total Assets:	$24.31 mil
Objective:	Growth	Purchase Constraints:	—		

Flows and Assets Under Management: Alternative Mutual Funds

Quarterly Alternative Mutual Fund Flows
During the second quarter of 2012, alternative mutual funds experienced net inflows of around $1.6 billion, an estimated 38.7% increase from last quarter. Net inflows were especially strong in the long-short equity category ($1.4 billion), which grew 65.9% quarter over quarter. The bear-market, managed-futures, market-neutral, and multialternative categories experienced smaller net inflows of $209 million, $182 million, $76 million, and $487 million, respectively. The currency category's net flows reversed from the previous quarter, resulting in a $58 million net outflow. The non-traditional-bond category continued to struggle, losing $710 million in the second quarter of 2012; this is the fourth consecutive quarter that non-traditional-bond funds have experienced outflows.



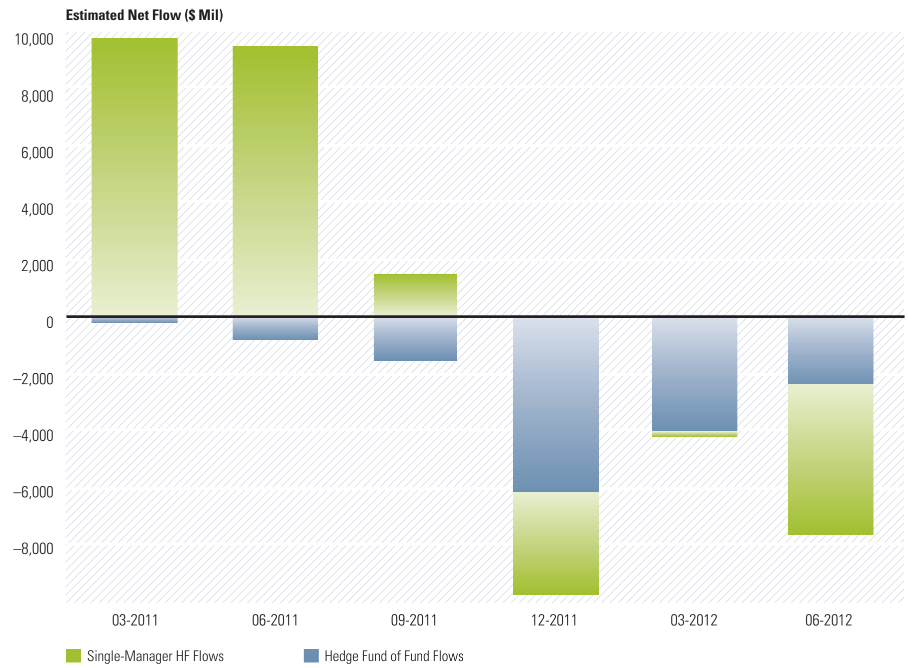
Quarterly Alternative Mutual Fund Assets Under Management
Assets under management for all alternative mutual funds increased 1.2% quarter over quarter, totaling more than $129 billion at the end of June 2012. Three of the seven alternative mutual fund categories gained assets in the second quarter. Bear-market and long-short equity funds experienced the most significant percentage gains in assets (10.5% and 5.5%, respectively) because of the strong quarterly returns (for the bear-market funds) and inflows (for the long-short equity funds). The bear-market category remains the smallest of all the alternative mutual fund categories at $3.9 billion as of June 30, 2012. Currency funds saw the largest, albeit relatively small, percentage drop in assets during the second quarter (2.9%). Non-traditional-bond, the largest alternative mutual fund category in terms of assets, experienced a slight dip in its total assets quarter over quarter (0.4%).



Flows and Assets Under Management: Hedge Funds

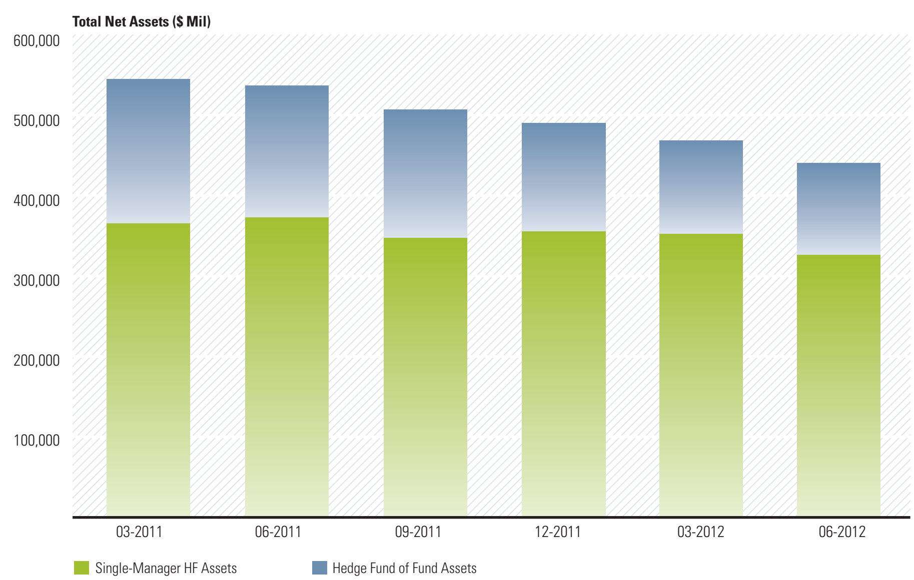
Quarterly Hedge Fund Flows

During the second quarter of 2012, single-manager hedge funds in Morningstar's database experienced outflows of almost $5.3 billion, and hedge funds of funds in Morningstar's database recorded outflows of almost $2.2 billion. Diversified arbitrage and debt arbitrage (single-manager) hedge funds continued their positive flow trend: $815 million and $517 million, respectively. Systematic futures and Europe long-short equity (single-manager) hedge funds experienced major outflows of $3.6 billion and $2.0 billion, respectively. For funds of hedge funds, event-driven-focused funds experienced the greatest inflows this quarter ($744 million), while multistrategy funds produced the greatest outflows ($1.9 billion).



Quarterly Hedge Fund Assets Under Management

In the second quarter of 2012, single-manager hedge fund assets under management in Morningstar's database decreased 9.2% quarter over quarter, to $323 million. Over the past year (through June 30, 2012) assets under management of single-manager hedge funds fell by 13.6% because of both outflows and poor performance. Hedge funds of funds in Morningstar's database managed 9.5% fewer assets than in the prior quarter, with $111.2 million assets recorded as of June 30, 2012. Assets under management of hedge funds of funds dropped 25.9% year over year (through June).

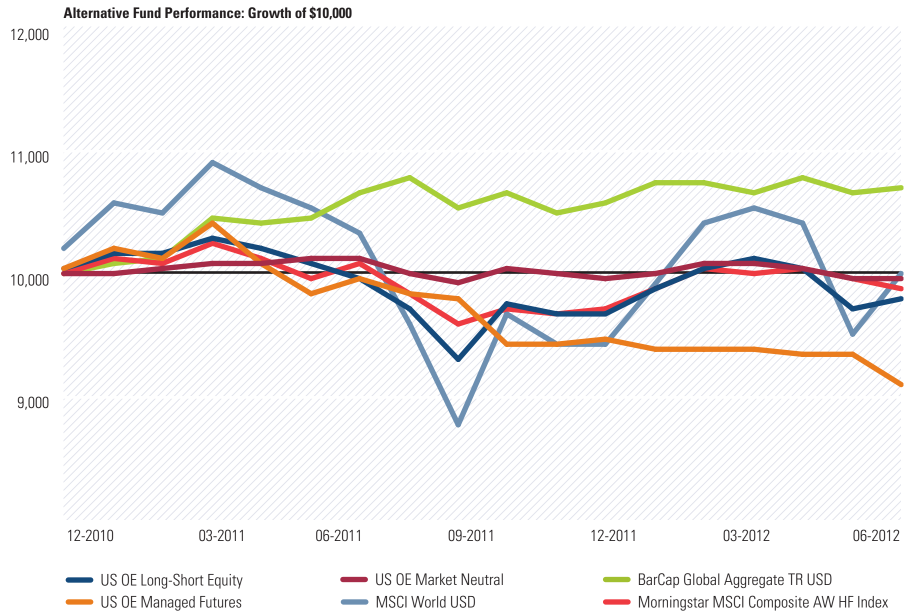


Morningstar does not report total hedge fund industry flows or assets, as these figures are based on estimates and projections of voluntarily reported information. Because of the addition of a large multistrategy hedge fund to Morningstar's database, the reported Q1 2012 net flow figure in this issue differs significantly from the last AIO newsletter's Q1 2012 net flow figure.

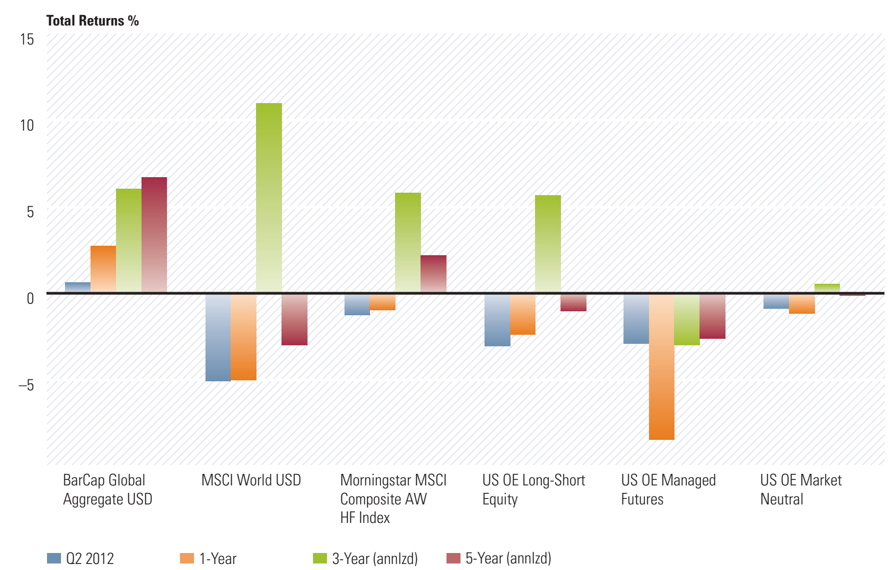
Alternative Investment Performance

Growth of a $10,000 Alternative Investment
Hedge funds, as proxied by the Morningstar MSCI Composite AW Hedge Fund Index, lost 1.2% in the second quarter, while global stocks, as represented by the MSCI World NR Index, lost 5.1%. Global bonds, as tracked by the Barclays Global Aggregate TR USD, eked out a gain of 0.6%. Over the 18 months ended June 2012, the Barclays Global Aggregate Bond Index outperformed both global stocks and hedge funds with a 7.2% return. Over the same period, the MSCI World NR Index ended up flat, while the Morningstar MSCI Composite AW Hedge Fund Index lost 1.1%. Similarly, in terms of mutual fund alternatives, both global bonds and global stocks outperformed the long-short equity, managed-futures, and market-neutral category averages over the past 18 months.

Morningstar no longer publishes proprietary hedge fund indexes. Morningstar now uses the Morningstar MSCI series of indexes, including the Morningstar MSCI Composite AW, a currency-hedged asset-weighted index of 1,000 hedge funds, or the applicable category averages.



Performance of Alternative Investments Over Time
Global bonds, as represented by the Barclays Global Aggregate TR USD Index, outperformed hedge funds (as represented by the Morningstar MSCI Composite AW Hedge Fund Index) as well as the long-short-equity, managed-futures, and market-neutral mutual fund category averages over the past quarter, one-year, and five-year time frames (ended June 30). Global stocks, as represented by the MSCI World NR USD Index, outperformed over a three-year time frame. Hedge funds recorded better returns than did global stocks over the past one-year and five-year periods. The average managed-futures mutual fund lost money in all four time periods (ended June 30, 2012).

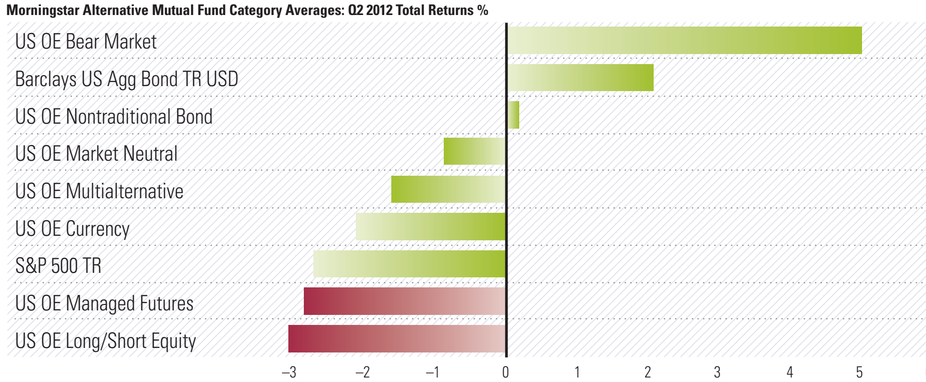


Q2 Performance by Category

Alternative Mutual Funds

Equities slumped in the second quarter of 2012. Long-short equity mutual funds dropped 3.1% this quarter. The average bear-market fund surged 5.1%. Bonds also rallied as equities slumped; the Barclays US Aggregate Bond TR USD Index and the non-traditional-bond fund category average climbed 2.1% and 0.2%, respectively. The U.S. dollar's appreciation against most major currencies troubled currency mutual funds, which fell on average 2.1% in the second quarter. Managed-futures, multialternative, and market-neutral mutual funds also struggled, losing 2.9%, 1.7%, and 0.9%, respectively, on average.

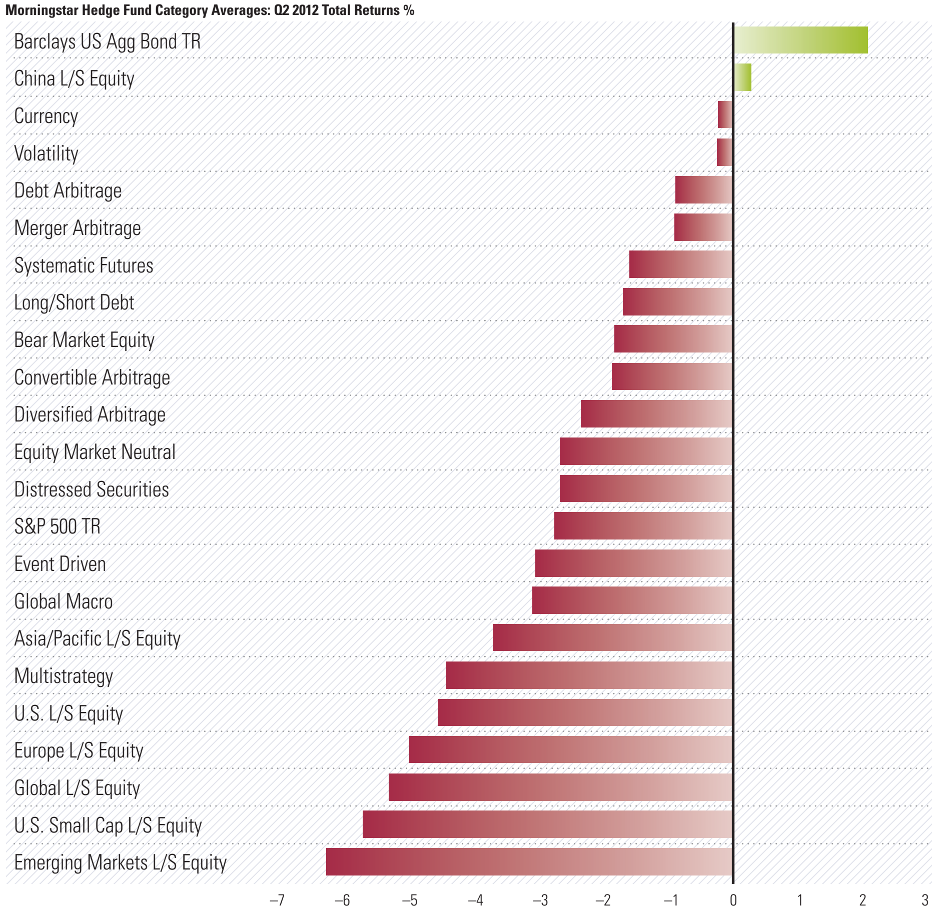
Morningstar Alternative Mutual Fund Category Averages: Q2 2012 Total Returns %



Hedge Funds

Hedge funds struggled in the second quarter of 2012. All hedge fund categories except China long-short equity produced losses. Long-short equity funds struggled the most; the emerging-markets long-short equity, the U.S. small-cap long-short equity, and the global long-short equity category averages were among the biggest losers, dropping 6.3%, 5.7%, and 5.3%, respectively, this quarter. U.S. bonds, as represented by the Barclays US Aggregate Bond TR Index, returned 2.1%, significantly outperforming all hedge fund categories and the S&P 500. Twelve of the 21 hedge fund categories beat the S&P 500 Index, which fell 2.8% this quarter. The best-performing hedge funds category averages were China long-short equity, currency, and volatility, which returned 0.3%, negative 0.2%, and negative 0.3%, respectively.

Morningstar Hedge Fund Category Averages: Q2 2012 Total Returns %

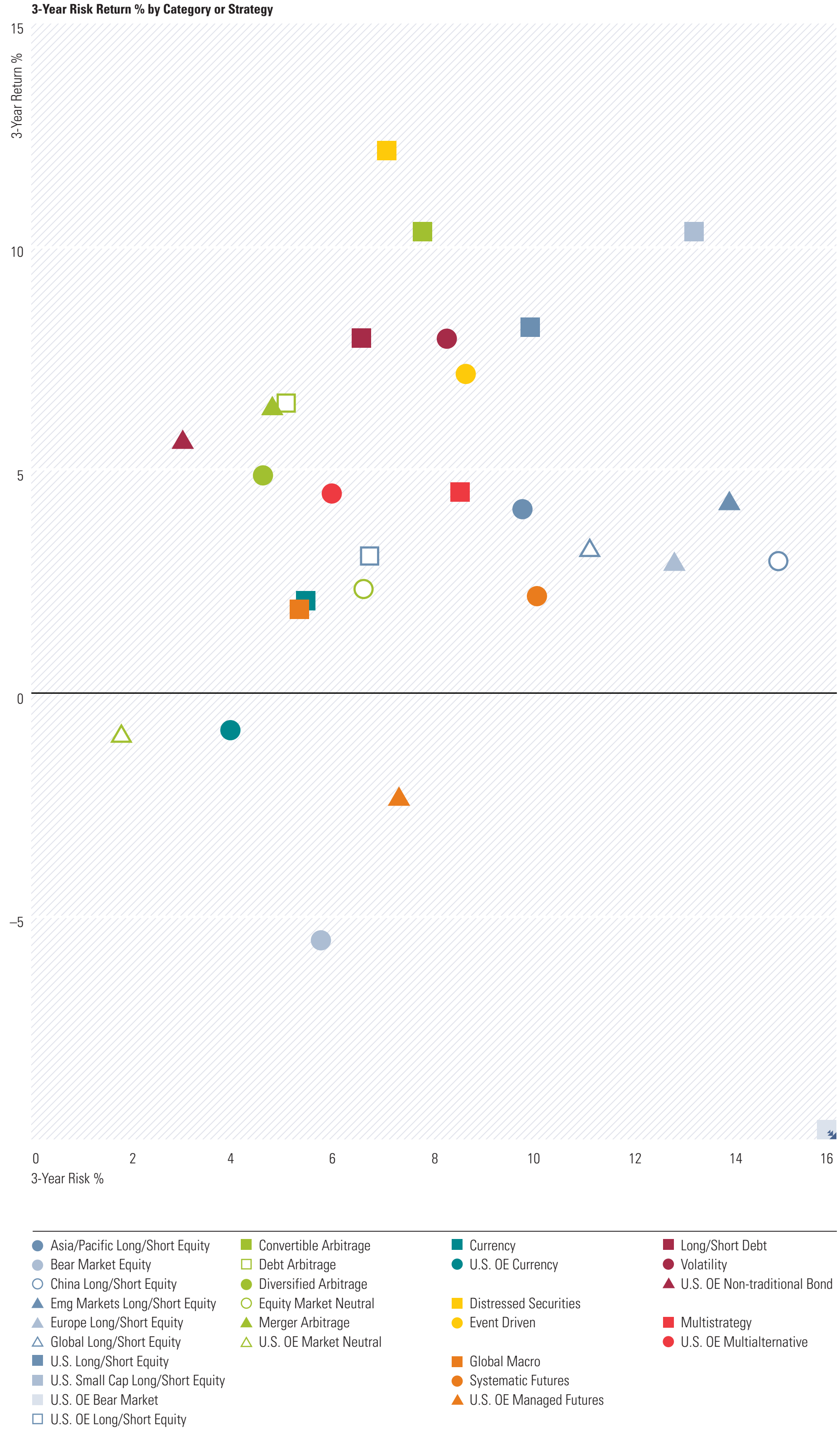


Risk Versus Return: Alternative Mutual Funds and Hedge Funds

Three-Year Standard Deviation and Return

Of the 28 alternative mutual fund and hedge fund category averages, 23 exhibited positive returns over the three years ended June 30, 2012. For the second quarter in a row, funds in the distressed securities, U.S. small-cap long-short equity, and convertible arbitrage hedge fund category averages produced the best three-year total returns, of 12.1%, 10.4%, and 10.3%, respectively. Non-traditional-bond mutual funds provided the best risk-adjusted returns on average along with distressed securities and merger-arbitrage hedge funds. In contrast, the U.S. bear-market mutual fund category experienced a 23.7% annualized decline over the three-year period ended June 30, 2012, while also exhibiting the highest (20.0% annualized) standard deviation. Bear-market hedge funds performed only slightly better, losing 5.5% on average with a 5.8% 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	–0.81	1.00					
3 US OE Long/Short Equity	–0.96	0.84	1.00				
4 US OE Managed Futures	–0.25	0.19	0.28	1.00			
5 US OE Market Neutral	–0.31	0.47	0.41	–0.27	1.00		
6 US OE Multialternative	–0.93	0.73	0.91	0.47	0.17	1.00	
7 US OE Nontraditional Bond	–0.64	0.57	0.68	0.11	0.15	0.70	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	–0.19	1.00																			
3 HF China Long/Short Equity	0.38	–0.34	1.00																		
4 HF Convertible Arbitrage	0.81	–0.20	0.47	1.00																	
5 HF Currency	0.57	–0.02	0.36	0.50	1.00																
6 HF Debt Arbitrage	0.80	–0.15	0.40	0.91	0.60	1.00															
7 HF Distressed Securities	0.86	–0.22	0.36	0.87	0.51	0.83	1.00														
8 HF Diversified Arbitrage	0.64	–0.14	0.45	0.74	0.36	0.76	0.70	1.00													
10 HF Emerging Mkts Long/Short Equity	0.75	–0.32	0.75	0.82	0.55	0.77	0.77	0.57	1.00												
11 HF Equity Market Neutral	0.82	–0.18	0.44	0.80	0.58	0.89	0.75	0.66	0.78	1.00											
12 HF Europe Long/Short Equity	0.88	–0.16	0.35	0.88	0.68	0.93	0.86	0.70	0.78	0.94	1.00										
13 HF Event Driven	0.87	–0.33	0.46	0.88	0.54	0.84	0.92	0.64	0.86	0.86	0.90	1.00									
14 HF Global Long/Short Equity	0.92	–0.22	0.46	0.89	0.63	0.91	0.89	0.68	0.86	0.93	0.96	0.95	1.00								
15 HF Global Macro	0.75	–0.04	0.45	0.69	0.83	0.76	0.61	0.46	0.69	0.81	0.82	0.71	0.81	1.00							
19 HF Long/Short Debt	0.84	–0.08	0.42	0.93	0.62	0.96	0.84	0.77	0.80	0.90	0.94	0.86	0.92	0.79	1.00						
20 HF Merger Arbitrage	0.83	–0.27	0.38	0.86	0.57	0.90	0.82	0.70	0.77	0.93	0.94	0.90	0.94	0.76	0.90	1.00					
21 HF Multistrategy	0.90	–0.14	0.45	0.88	0.69	0.93	0.85	0.69	0.82	0.94	0.97	0.91	0.98	0.87	0.95	0.92	1.00				
22 HF Systematic Futures	0.56	0.06	0.36	0.45	0.77	0.52	0.44	0.28	0.45	0.54	0.58	0.48	0.59	0.82	0.53	0.49	0.66	1.00			
23 HF U.S. Long/Short Equity	0.90	–0.33	0.48	0.85	0.50	0.81	0.91	0.63	0.85	0.85	0.87	0.97	0.95	0.69	0.82	0.87	0.89	0.48	1.00		
24 HF U.S. Small Cap Long/Short Equity	0.87	–0.30	0.51	0.82	0.52	0.77	0.88	0.59	0.85	0.83	0.84	0.94	0.93	0.71	0.78	0.84	0.88	0.54	0.98	1.00	
25 HF Volatility	–0.10	0.22	0.07	0.03	0.10	0.10	–0.15	0.05	–0.12	0.11	0.05	–0.10	0.00	0.26	0.10	0.06	0.12	0.40	–0.12	–0.05	1.00

1.00 to 0.76 · 0.75 to 0.51 · 0.50 to 0.26 · 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

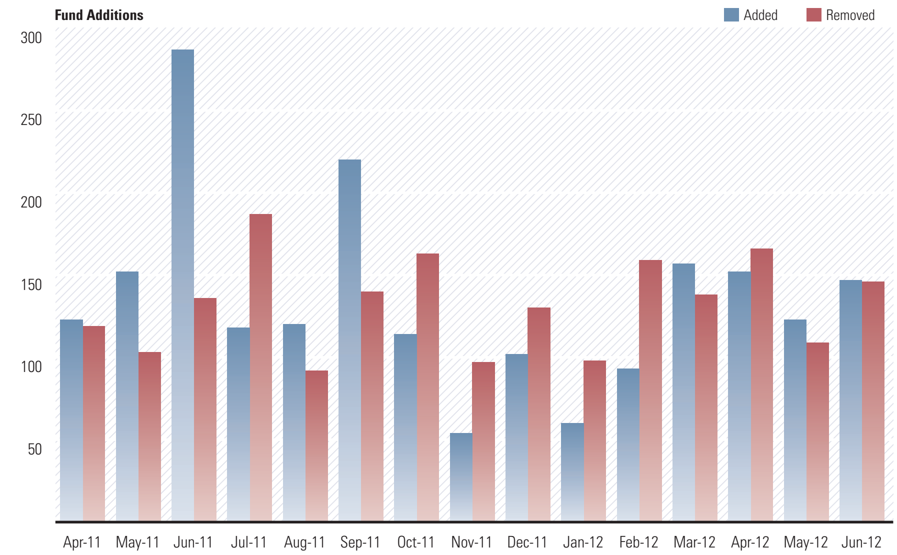
Correlation of Mutual Funds to U.S. Stocks and Bonds	S&P 500 Correlation (USD)			BarCap US Agg Correlation (USD)		
	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
US OE Bear Market	–0.97	–0.97	–0.96	0.26	–0.18	–0.03
US OE Currency	0.73	0.52	0.29	–0.12	–0.03	0.21
US OE Long/Short Equity	0.96	0.95	0.87	–0.31	0.10	0.05
US OE Managed Futures	0.27	–0.24	N/A	–0.04	–0.34	N/A
US OE Market Neutral	0.32	0.14	–0.12	–0.09	0.05	0.13
US OE Multialternative	0.93	0.94	0.90	–0.16	0.21	0.03
US OE Nontraditional Bond	0.62	0.73	0.59	0.02	0.21	0.34

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 HF Index	0.79	0.69	0.65	–0.13	0.11	0.04
HF Asia/Pacific Long/Short Equity	0.84	0.81	0.69	–0.21	0.24	0.11
HF Bear Market Equity	–0.46	–0.45	–0.48	0.18	0.01	0.05
HF China Long/Short Equity	0.41	0.32	N/A	–0.04	0.11	N/A
HF Convertible Arbitrage	0.80	0.75	0.66	–0.06	0.31	0.22
HF Currency	0.51	0.38	0.29	0.06	0.20	0.24
HF Debt Arbitrage	0.81	0.78	0.67	–0.03	0.27	0.22
HF Distressed Securities	0.83	0.81	0.74	–0.27	0.03	–0.03
HF Diversified Arbitrage	0.61	0.63	0.55	–0.04	0.25	0.20
HF Emerging Markets Long/Short Equity	0.76	0.76	0.73	–0.11	0.17	0.09
HF Equity Market Neutral	0.83	0.74	0.63	–0.14	0.21	0.17
HF Europe Long/Short Equity	0.88	0.81	0.75	–0.17	0.18	0.11
HF Event Driven	0.91	0.85	0.80	–0.19	0.13	0.05
HF Global Long/Short Equity	0.92	0.85	0.78	–0.19	0.18	0.07
HF Global Macro	0.69	0.55	0.51	0.07	0.26	0.18
HF Long/Short Debt	0.78	0.77	0.68	0.00	0.34	0.29
HF Merger Arbitrage	0.87	0.82	0.76	–0.15	0.31	0.19
HF Multistrategy	0.87	0.77	0.74	–0.09	0.19	0.09
HF Systematic Futures	0.45	0.10	0.05	0.11	0.06	0.17
HF U.S. Long/Short Equity	0.95	0.90	0.88	–0.31	0.04	–0.04
HF U.S. Small Cap Long/Short Equity	0.90	0.88	0.86	–0.30	0.04	–0.06
HF Volatility	–0.06	0.25	0.16	0.24	0.48	0.31

Morningstar Hedge Fund Database Overview as of 06-30-2012

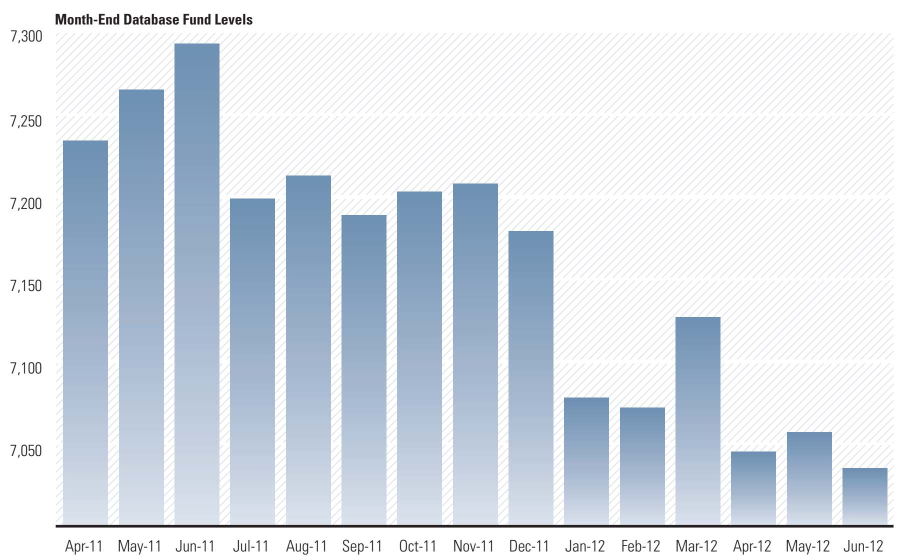
Net Fund Additions by Month

Morningstar's hedge fund database experienced a net removal of one fund during the second quarter of 2012. The database saw 422 additions and 421 fund withdrawals 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 decision to supply data to Morningstar.



Month-End Database Fund Levels

As of June 30, 2012, the Morningstar hedge fund database contained 7,035 funds that actively report performance and assets-under-management data. This figure includes about 5,000 single-manager hedge funds and about 2,000 funds of hedge funds. As of quarter-end, the number of funds in the database had dropped approximately 3% from April 2011 levels.

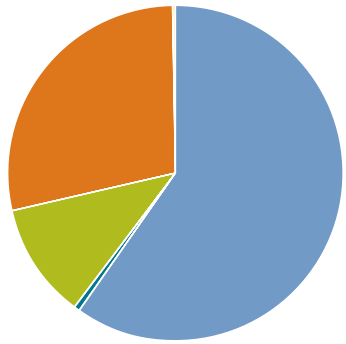


Morningstar Hedge Fund Database Overview as of 06-30-2012

Hedge Funds by Region

Approximately 60% of hedge funds in the Morningstar database are legally domiciled in the North American/Caribbean region, primarily in the Cayman Islands and United States. A large percentage of U.K. hedge funds are also domiciled in the Cayman Islands for tax and regulatory purposes. Approximately 28% of funds in Morningstar's database are domiciled in Europe, including both European Union and non-EU jurisdictions, and 11% of funds are domiciled in Asia and Australia, primarily in China (95%). All figures are as of July 5, 2012.

Morningstar Hedge Fund Database by Region



Region	# Funds
N. America/Carribean	4,370
Africa	35
Asia/Australia	781
Europe	1,931
South America	7
Other	0
Total	**7,124**

Hedge Funds by Location

Approximately 78% 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	**4,211**
Cayman Islands	1,866
United States	1,312
British Virgin Islands	442
Bermuda	311
Canada	204
Curacao	46
Bahamas	25
St. Vincent & the Grenadines	1
Panama	1
Barbados	1
Anguilla	1
St. Kitts & Nevis	1

Africa	**40**
Mauritius	24
South Africa	15
Swaziland	1

Asia and Australia	**787**
Australia	30
Bahrain	1
China	745
Christmas Island	1
Hong Kong	5
Japan	2
Marshall Islands	1
Singapore	1
Vanuatu	1

Europe	**1,990**
Luxembourg	777
Ireland	201
France	181
Switzerland	161
Guernsey	145
Italy	112
Jersey	69
Sweden	68
Malta	60
Liechtenstein	46
Netherlands	42
Spain	33
United Kingdom	22
Finland	14
Germany	11
Channel Islands	10
Austria	9
Isle of Man	8
Denmark	6
Cyprus	3
Norway	3
Gibraltar	2
Macedonia	2
Portugal	2
Andorra	1
Belgium	1
Greece	1

South America	**6**
Brazil	6

Morningstar Hedge Fund Database Overview as of 06-30-2012

Service Providers

Morgan Stanley and Goldman Sachs are the largest prime brokerage-service providers to hedge funds in Morningstar's database, serving a 34% share combined. The big four accounting firms are employed by approximately 76% of the hedge funds listed in Morningstar's database, with PricewaterhouseCoopers leading the pack. Citco Fund Services provides administration services to 8% of funds in Morningstar's database, significantly more than the next-largest administrator, CIBC/BNY Mellon, which services less than 4% of funds in the database. Maples & Calder, Walkers, and Seward & Kissel are the three largest legal-counsel-service providers to hedge funds in the database, with a combined 28% market share.

Type	Rank	Service Provider	% of Database
Prime Broker	1	Morgan Stanley	18.03
	2	Goldman Sachs	15.78
	3	Deutsche Bank	8.91
	4	UBS	8.70
	5	Credit Suisse	7.74
	6	JPMorgan	6.57
	7	Bank of America/Merrill Lynch	4.08
	8	Newedge	3.96
	9	Citigroup	2.82
	10	BNP Paribas	2.58
Legal Counsel	1	Maples & Calder	10.53
	2	Walkers	10.40
	3	Seward & Kissel	6.73
	4	Dechert LLP	6.31
	5	Elvinger, Hoss & Prussen	4.43
	6	Simmons & Simmons	4.30
	7	Schulte Roth & Zabel	3.46
	8	Sidley Austin	3.33
	9	Ogier	2.99
	10	Appleby	2.46
Auditor	1	Pricewaterhouse Coopers	24.00
	2	Ernst & Young	21.50
	3	KPMG	17.64
	4	Deloitte	12.94
	5	Rothstein Kass	5.07
	6	RSM / McGladery & Pullen	2.68
	7	Grant Thornton	2.16
	8	BDO	2.08
	9	Eisner	1.48
	10	Arthur Bell	0.79
Administrator	1	Citco	8.38
	2	CIBC / BNY Mellon	3.90
	3	Citigroup / BISYS	3.57
	4	HSBC	3.39
	5	State Street / IFS	2.97
	6	Credit Suisse / Fortis	2.87
	7	SS&C GlobeOp	2.61
	8	UBS	2.45
	9	Northern Trust	2.30
	10	CACEIS Fastnet	2.30

Alternative Investments Observer

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