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Quanto? Cuanto? Combien?

The answer to the most frequently asked question about alternatives.



by
Tim Galbraith
Head of Alternative Investment Strategies
Morningstar Associates, LLC

The most frequently asked question posed to me is always, “What percentage of my portfolio should be in alternatives?” Never a day goes by without the question surfacing. Financial advisors lean forward with rapt attention awaiting the answer, as if I just trudged down the mount with my stone tablets.

Admittedly, my response lacks specifics. I thoughtfully answer by supplying a gumbo of comments about the historical weight to alternatives, the shifting definition of alternatives, and, of course, the liquidity and suitability needs of the client being vital. Inevitably, my answer is about a range—a wide range—of possible allocations. The lack of a specific answer is professionally frustrating and probably disappoints many advisors who seek guidance in these volatile markets. After all the years of data and great computational and analytical skills, why aren't we able to distill a decent answer?

First things first: What is an alternative investment? The first challenge in answering the question of how much should be invested is the unclear and changing definition of alternatives. There is not one all-encompassing, agreed-upon description. Morningstar defines alternative investments as those that trade atypical asset classes (such as commodities or currencies) or strategies (such as shorting or hedging), or assets that are very illiquid (such as private equity or private debt). This definition means different things to different investors, however.

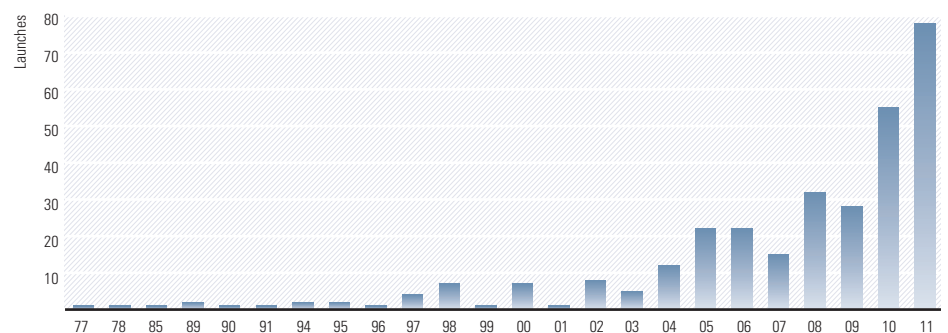
Furthermore, the definition of alternatives has changed over time. Historically, alternatives were considered to be hedge funds—unregistered legal structures with liquidity restrictions and high net-worth thresholds that prevented access to most retail investors. As a result, alternatives were considered investments

suitable for a small portion of the population and the portfolio. Now, with more than 300 hedge-fundlike mutual funds (and several exchange-traded funds) available to the general market, the legal structure is no longer a defining characteristic. (See Exhibit 1.)

Even when classifying alternatives by their underlying assets or trading strategies, the challenge lies in the changing definition of alternatives over time. Ten years ago emerging-markets equities and global REITs were largely grouped as alternatives. Does that classification hold today as these asset classes have been adopted by mainstream investors? And will commodities be considered alternatives in 10 years' time? Measuring alternatives by a popularity contest does not lead to a constructive understanding.

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Exhibit 1: New Alternative Mutual Fund Launches by Year



Nevertheless, the rapid growth of liquid alternative mutual funds and ETFs, both in number and asset size, has challenged all definitions of alternatives, the perception of who should invest in them, and, most important, how much should be invested. These new products are available to all classes of investors, and their growth is substantial. As of year-end, Morningstar counted total alternative mutual funds assets of \$122 billion after five consecutive years of positive inflows and new product launches at a blistering pace of approximately four per month. Compare that with the five consecutive years of outflows from U.S.-equity mutual funds that total just more than \$260 billion. (See Exhibit 2.) For those clutching to the definition that alternatives are rare and small parts of a portfolio, consider how those negative flows add up: Is it possible in the future that long-only U.S.-equity funds could become the minority in a portfolio and thus be considered “alternative”?

The History of How Much

For retail financial advisors, the historical answer to how much should be in alternatives was 10%. This answer was rooted in the assumption that alternatives were hedge funds. Because hedge funds locked your money up for a year and gave you only quarterly redemptions, why would you have more than 10% in such restrictive products? Moreover,

a hedge fund manager could blow your entire investment on a bad bet, or the unscrupulous manager could just walk away with your cash. In short, the 10% rule of thumb was not based on any hard science, as it was fundamentally a safety- and liquidity-driven allocation.

That’s not to say that academia didn’t attempt to answer the alternatives-allocation question with definitive data. Much of the first academic research on alternatives focused on deconstructing hedge fund returns, searching for whether they came from alpha, traditional beta, hedge fund beta, or leverage. Additional research focused on the difficulties of getting a decent set of return data in the first place. There has been much written about the hedge fund indexes and their inadequacies. It is quite a list of warts: The returns data were monthly in frequency, lagged at least one month, were self-reported, were fraught with survivorship and backfill bias, incorporated various amounts of leverage, and were sometimes discovered to be completely fraudulent. And, of course, the accredited investor standard made those returns out of reach for most retail investors. Given all the data challenges and self-imposed constraints, one group of researchers at UBS Asset Management in 2003 described its alternatives-allocation policy as “appropriate” rather than optimal.¹

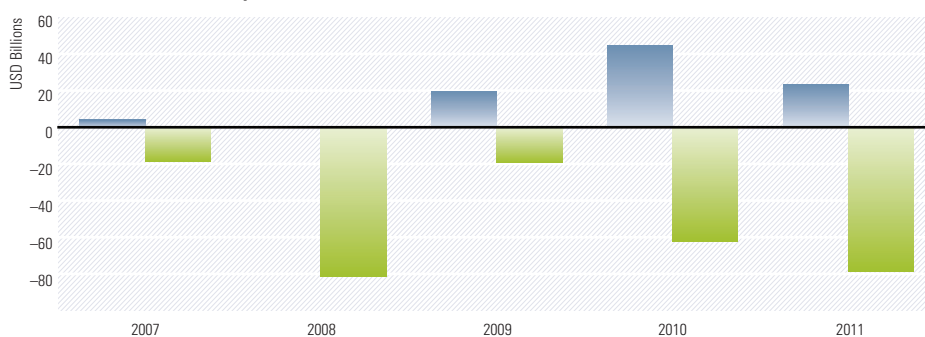
As time passed, more hard numbers emerged from the institutional world. College endowments had dollar weightings to alternatives rise to more than 50%,² following a practice championed by Yale’s endowment CIO David Swensen. These alternatives were primarily illiquid hedge funds, private equity, or direct investments in hard assets. Swensen believed that institutions’ virtually infinite investment horizon enabled them to take on significant liquidity risk (in the hopes of reaping premium returns). Heavy allocations to illiquid alternatives were challenged in the wake of the 2008 financial crisis, however, when institutions experienced significant investment losses and operating cash shortfalls. In late 2010, the CFA Institute began to recommend (in its Investment Management Code of Conduct for Endowments, Foundations, and Charitable Organizations) that institutions consider illiquidity and incorporate appropriate limitations or restrictions on investments with defined capital lockup periods. For retail investors, though, who had always limited their exposure to illiquidity, the 10% principle was still in effect.

Finally, Some Answers

Fast-forward to today. Many brokerage houses now commit to print their recommendations for alternative weightings. Compared with yesteryear’s 10% rule, the numbers are breathtaking.

- ▶ In March 2011, the research investment committee inside Merrill Lynch’s wealth management division recommended that alternatives fit in a range from 5% to 45%.
- ▶ In December 2011, UBS’ wealth management research published its 2012 outlook with benchmark guidelines for “nontraditional assets” ranging from 9% to 27%.

Exhibit 2: Mutual Fund Flows by Asset Class



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¹ Terhaar, Kevin; Staub, Renato; and Singer, Brian. “Appropriate Policy Allocations for Alternative Investments.” *The Journal of Portfolio Management*. Spring 2003.
² 2010 NACUBO-Commonfund Study of Endowments, p. 15. Copyright 2011. National Association of College and University Business Officers and Commonfund Institute.

- ▶ In December 2011, the tactical asset-allocation models from Morgan Stanley Smith Barney's global investment committee suggested that "global alternative-absolute return" investments have a range weighting from 9% to 29%.
- ▶ In September 2011, Wells Fargo Advisors' strategic models called for alternatives' range from 14% to 25%.

Each recommendation is subject to change and is sensitive to the needs and circumstances of individual clients, of course. Collectively, the aforementioned wire houses recommend starting with no or minimal alternative allocations for conservative investors and increasing the weightings for clients with more-aggressive risk appetites. Merrill Lynch's guidelines also incorporate the liquidity needs of its clients, virtually barring alternatives for those needing a 100% liquid portfolio.

As expected, the definition of alternatives varies among the brokerage firms—one's "alternatives" is another's "nontraditional assets" or another's "absolute returns." All consider hedge funds, private equity, commodities, and managed futures to be alternatives. Merrill Lynch and Morgan Stanley Smith Barney include Treasury Inflation-Protected Securities and REITs in the description, whereas Wells Fargo and UBS tuck those under more-traditional asset-allocation headings.

Regardless of the recommended allocations' subtleties, the 10% rule is left in the dust. One likely catalyst is the plethora of alternatives now available in the form of mutual funds and ETFs offering daily liquidity. It is highly unlikely that a financial advisor could assemble an asset-allocation plan for a retail client with 30% invested exclusively in hedge funds. No such asset-allocation plan concentrated in hedge funds would pass muster with a branch

and compliance manager, especially after the heightened interest in liquidity and the highly publicized hedge fund disasters of the financial crisis. As a result, financial advisors planning for larger alternative allocations are forced to look for solutions in the daily liquid alternative mutual fund universe.

Liquid Alternatives Are Here to Stay

It is ironic that the rise of more alternative weightings in a portfolio isn't necessarily a boon for the hedge fund business. Morningstar's hedge fund database still counts 7,700 funds, but asset-raising has become more difficult, especially for smaller funds. I would suggest that the 10% rule may still be alive, but now it has become a ceiling for those still offering strategies in only a nonliquid, limited partnership format. Alternative asset managers offering products in only the traditional limited partnership structure will need to create mutual fund products to capture a share of this growing liquid alternative market. The new alternative mutual funds and ETFs must perform, however, in order to justify the rising allocations to alternatives. Lackluster returns could easily drain investors' newfound confidence in alternative investments. Given the current trajectory of assets in liquid alternatives and the growing recommended allocations, I expect new products and new entrants to keep the alternative industry dynamic for years to come. ■■■

Combining Liquidity and Momentum to Pick Top-Performing Mutual Funds

U.S.-equity funds exhibiting low liquidity and high momentum have outperformed.



by
Thomas Idzorek, CFA
Chief Investment Officer
Ibbotson Associates, a Morningstar
Company

James X. Xiong, Ph.D., CFA
Senior Research Consultant
Ibbotson Associates, a Morningstar
Company

Roger G. Ibbotson, Ph.D.
Chairman & CIO
Zebra Capital Management, LLC

Current Draft: January 2011
Initial Draft: Aug. 5, 2010

This study is an abridged version of the original study, published on Morningstar's website:

<http://corporate.morningstar.com/us/documents/MethodologyDocuments/IBBAssociates/CombiningLiquidityMomentum.pdf>.

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Introduction

The two best-known market anomalies that historically have produced risk-adjusted excess returns are the Fama-French anomalies of value minus growth and small minus large. The next most-known market anomaly is momentum, which is sometimes referred to as the "Carhart factor" (Carhart [1997]). One of the pioneering articles on exploiting the momentum anomaly is Jegadeesh and Titman (1993), which details a process for overweighting recent winners (securities with high momentum) and underweighting recent losers (securities with low momentum). The momentum effect has been widely observed across global equity markets even though the exact source of the momentum anomaly is still in debate (for example, Chordia and Shivakumar [2002], Cooper, Gutierrez, and Hameed [2004], and Griffin, Ji, and Martin [2005]).

Moving beyond these three market anomalies, we believe the next major market anomaly to be discovered, and one with unexplained risk-adjusted returns that rival those of the other anomalies, is liquidity. The liquidity investment style refers to the process of investing in relatively less-liquid stocks within the relatively liquid universe of publicly traded stocks. A number of studies find that, cross-sectionally, stock returns are decreasing with stock turnover, which is consistent with a negative relationship between liquidity and

expected return. The superior returns associated with less-liquid investments are documented in, for example, Amihud and Mendelson (1986), Datar, Naik, and Radcliffe (1998), Chordia, Subrahmanyam, and Anshuman (2001), Pastor and Stambaugh (2003), and, more recently, Chen, Ibbotson, and Hu (2010).

In the precursor to this study, Idzorek, Xiong, and Ibbotson (IXI [2010]) combines data from Morningstar's individual stock database with Morningstar's mutual fund holding database to build composites of mutual funds based on liquidity, finding that composites of mutual funds that hold relatively less-liquid stocks dramatically outperformed composites of mutual funds that hold more-liquid stocks. Using the same techniques, this paper extends that research to investigate if composites of mutual funds that hold stocks with high momentum outperform composites of mutual funds that hold stocks with low momentum. Additionally, we build composites of mutual funds based on a combination of liquidity and momentum factors.

Data and Methodology

To investigate whether mutual funds that hold stocks with high momentum tend to outperform mutual funds that hold stocks with low momentum, we combined data from Morningstar's individual stock database with Morningstar's mutual fund holdings database.

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For each stock in the database, we calculated its trailing six-month total return throughout time. Coupling this information with the mutual fund holdings database enabled us to calculate each mutual fund's weighted average momentum throughout time.

We started with Morningstar's open-end U.S.- equity mutual fund universe containing both live and dead funds. The Morningstar categories represented within the U.S.-equity mutual fund universe included those of the nine size-valuation style boxes that form the U.S.- equity universe, the three valuation-based columns from the Morningstar Style Box™ (value, core, and growth) and the three size- based rows from the Morningstar Style Box (large, mid, and small).

Morningstar has either monthly or quarterly mutual fund holdings data starting in 1983; however, wide-scale holdings data were not available until 1995. Holdings data from January 1995 were used to form the composites of mutual funds that we begin tracking in February 1995. The constituent mutual funds of the composites are based on the previous month's holdings information.

Table 1: Number of Funds With Required Data

Morningstar Category	Start Date Number of Funds	End Date Number of Funds
Small Value	42	238
Small Core	73	369
Small Growth	123	494
Mid Value	45	229
Mid Core	84	314
Mid Growth	131	527
Large Value	212	719
Large Core	322	1,260
Large Growth	262	1,048
Small	238	1,101
Mid	260	1,070
Large	796	3,027
Value	299	1,186
Core	479	1,943
Growth	516	2,069
All U.S.	1,294	5,198

Table 2: Monthly-Rebalanced Composites—Performance Statistics

U.S.-Equity Fund Universe (February 1995–December 2009)

Mutual Fund Quintiles, where M1 = Lowest Momentum and M5 = Highest Momentum

	N Periods	Arithmetic Mean %	Geometric Mean %	Standard Deviations %	Sharp Ratio	Monthly Alpha Rel to Avg %
Small Value Avg	179	11.68	10.01	19.26	0.42	—
M5 minus M1	179	4.70	4.82	-0.39	0.24	0.40
Small Core Avg	179	11.12	9.32	19.94	0.38	—
M5 minus M1	179	3.22	2.99	1.64	0.12	0.19
Small Growth Avg	179	9.95	7.39	23.76	0.27	—
M5 minus M1	179	6.80	6.32	3.21	0.25	0.44
Mid Value Avg	179	11.14	9.73	17.55	0.43	—
M5 minus M1	179	3.13	3.45	-1.79	0.21	0.35
Mid Core Avg	179	11.19	9.59	18.77	0.41	—
M5 minus M1	179	6.84	6.74	1.22	0.32	0.49
Mid Growth Avg	179	10.41	8.15	22.35	0.31	—
M5 minus M1	179	7.59	7.08	3.52	0.29	0.48
Large Value Avg	179	9.25	7.83	17.61	0.33	—
M5 minus M1	179	6.18	5.97	1.81	0.30	0.43
Large Core Avg	179	8.10	6.86	16.32	0.28	—
M5 minus M1	179	4.50	4.52	0.21	0.27	0.36
Large Growth Avg	179	8.26	6.59	18.98	0.25	—
M5 minus M1	179	6.00	5.82	1.63	0.28	0.43
Small Avg	179	10.56	8.52	21.20	0.33	—
M5 minus M1	179	6.05	5.46	3.61	0.22	0.34
Mid Avg	179	10.63	8.80	20.06	0.35	—
M5 minus M1	179	7.74	7.22	3.59	0.31	0.46
Large Avg	179	8.23	6.91	16.83	0.28	—
M5 minus M1	179	6.60	6.50	1.17	0.35	0.49
Growth Avg	179	8.98	7.05	20.44	0.27	—
M5 minus M1	179	7.87	7.30	3.76	0.32	0.51
Core Avg	179	9.23	7.88	17.06	0.33	—
M5 minus M1	179	6.49	6.26	1.91	0.32	0.46
Value Avg	179	9.48	8.23	16.42	0.36	—
M5 minus M1	179	4.66	4.78	-0.55	0.28	0.42
All Avg	179	9.09	7.60	17.97	0.31	—
M5 minus M1	179	7.44	6.95	3.39	0.33	0.47

This gives us 14 years and 11 months of performance history. Table 1 summarizes the number of live funds in the various universes/categories with the required data at the start of the study and at the end of the study.

For a given mutual fund, if we did not know the momentum for a holding, we ignored the position and rescaled the other holdings prior to calculating the mutual fund's weighted average momentum.

Armed with each mutual fund's weighted average momentum within any given category, we ranked the mutual funds based on their weighted average momentum and used this information to form evolving, monthly rebalanced, equally weighted composites (in our case quintiles) of mutual funds with similar weighted average momentum. Funds with the lowest weighted average momentum were

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Table 3: Liquidity Composites vs. Momentum Composites

U.S.-Equity Fund Universe (February 1995–December 2009)

Mutual Fund Quintiles, where L1 = Lowest Liquidity, L5 = Highest Liquidity, M1 = Lowest Momentum, and M5 = Highest Momentum

Liquidity Results	N Periods	Arithmetic Mean %	Geometric Mean %	Standard Deviations %	Sharp Ratio	Monthly Alpha Rel to Avg %	T-Statistic of Alpha Rel to Avg
All L5	179	9.22	6.44	24.83	0.23	-0.22	-1.33
All L4	179	9.44	7.58	20.16	0.29	-0.07	-1.19
All L3	179	8.58	7.15	17.58	0.29	-0.03	-0.75
All L2	179	9.24	7.98	16.56	0.35	0.08	1.06
All L1	179	10.16	9.09	15.25	0.43	0.23	2.05
All L Avg	179	9.33	7.80	18.20	0.32	—	—
L1 Minus L5		0.94	2.65	-9.58	0.21	0.45	—
Momentum Results							
All M1	179	5.44	3.86	18.25	0.10	-0.29	-2.15
All M2	179	7.47	6.14	16.83	0.23	-0.09	-1.16
All M3	179	9.11	7.72	17.34	0.32	0.01	0.31
All M4	179	10.70	9.14	18.49	0.39	0.10	2.42
All M5	179	12.88	10.81	21.64	0.43	0.18	1.55
All M Avg	179	9.09	7.60	17.97	0.31	—	—
M5 Minus M1		7.44	6.95	3.39	0.33	0.47	—
Liquidity Minus Momentum							
All L5–All M1		3.78	2.58	6.58	0.13	0.07	0.82
All L4–All M2		1.97	1.44	3.33	0.06	0.02	-0.03
All L3–All M3		-0.53	-0.57	0.24	-0.03	-0.04	-1.06
All L2–All M4		-1.46	-1.16	-1.93	-0.04	-0.02	-1.36
All L1–All M5		-2.72	-1.72	-6.39	0.00	0.05	0.50
All L Avg–All M Avg		0.24	0.20	0.23	0.01		

assigned to the “M1” quintile, and funds with the highest weighted average momentum were assigned to the “M5” quintile. The constituent mutual funds in the composite evolve each month as the weighted average momentum of the mutual funds evolves. Following this type of strategy would require the investor to rebalance the portfolio of mutual funds monthly.

Results

Momentum Composites

For momentum composites, Table 2 summarizes the results for our entire universe and the 15 categories within our universe of U.S.-equity

funds. The table displays the annual arithmetic return, annual geometric return, standard deviation, Sharpe ratio, and the alpha from a monthly return regression of the composite relative to its category average composite. (See the original study results for each category quintile’s statistics, including the t-statistic of the alphas.) When appropriate, we show the difference in performance statistics from the low-momentum composite (M1) and the high-momentum composite (M5).

For each of the 16 groupings, the high-momentum composite (M5) had a superior annual arithmetic return, annual geometric

return, Sharpe ratio, and monthly alpha when compared with the applicable equally weighted composite for that category. The t-statistic of the alpha of the high-momentum composite exceeded 2 for nine of our 16 categories, indicating that the alpha was statistically significant at the 95% confidence level. In contrast with the equivalent liquidity-based composites and analysis of IXI 2010, the t-statistic of the alpha of the low-liquidity composite exceeded 2 for 15 of the 16 categories, suggesting that, from this particular lens, building portfolios based on momentum is slightly less compelling than liquidity.

The performance of the “All” composites at the bottom of Table 2 (representing our entire universe of U.S.-equity funds) highlights the superiority of the high-momentum composites over the low-momentum composites. Comparing the All M5 composite with the All M1 composite, the annual geometric return was 6.95 percentage points better, the standard deviation was 3.39 worse, and the Sharpe ratio was significantly better (0.43 versus 0.10).

The largest monthly alpha differences between the M1 and M5 quintiles occurred within the growth category (51 basis points), while the smallest monthly alpha difference occurred for the small-core category (19 basis points).

To aid with comparisons between equivalent “All” liquidity composites from IXI 2010 with the “All” momentum composites, Table 3 shows the two sets of results as well as the differences.¹ Table 3 demonstrates that, on their own, composites of mutual funds holding low-liquidity stocks and composites of mutual funds holding high-momentum stocks outperform.

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¹ To ease the comparison, we list the low-liquidity L1 composite (the better-performing composite) results at the bottom and the high-liquidity L5 composite results at the top, which is the opposite direction in which they were displayed in IXI 2010.

Table 4: Liquidity and Momentum Composites—Performance Statistics

U.S.-Equity Fund Universe (February 1995–December 2009)

L+M 1 = High Liquidity Low Momentum and L+M 5 = Low Liquidity High Momentum

	N Periods	Arithmetic Mean %	Geometric Mean %	Standard Deviations %	Sharp Ratio	Monthly Alpha Rel to Avg %
Small Value Avg	179	11.71	10.03	19.24	0.42	—
L+M 5 minus L+M 1	179	4.33	4.69	-1.70	0.25	0.44
Small Core Avg	179	11.12	9.32	19.94	0.38	—
L+M 5 minus L+M 1	179	4.32	4.40	0.00	0.21	0.35
Small Growth Avg	179	9.97	7.41	23.76	0.27	—
L+M 5 minus L+M 1	179	8.47	8.43	1.32	0.33	0.65
Mid Value Avg	179	11.22	9.81	17.56	0.44	—
L+M 5 minus L+M 1	179	4.77	5.39	-3.36	0.34	0.56
Mid Core Avg	179	11.19	9.58	18.77	0.41	—
L+M 5 minus L+M 1	179	6.65	6.94	-1.06	0.36	0.59
Mid Growth Avg	179	10.41	8.15	22.33	0.31	—
L+M 5 minus L+M 1	179	9.65	9.91	0.13	0.41	0.79
Large Value Avg	179	8.54	7.36	15.88	0.32	—
L+M 5 minus L+M 1	179	4.42	4.83	-2.51	0.33	0.47
Large Core Avg	179	8.11	6.86	16.32	0.28	—
L+M 5 minus L+M 1	179	5.44	5.68	-1.06	0.34	0.49
Large Growth Avg	179	8.26	6.60	18.98	0.25	—
L+M 5 minus L+M 1	179	7.49	7.89	-1.24	0.38	0.66
Small Avg	179	10.57	8.53	21.19	0.33	—
L+M 5 minus L+M 1	179	8.95	8.75	2.00	0.36	0.66
Mid Avg	179	10.64	8.80	20.05	0.35	—
L+M 5 minus L+M 1	179	9.38	9.43	0.89	0.42	0.73
Large Avg	179	8.23	6.92	16.83	0.28	—
L+M 5 minus L+M 1	179	8.26	8.54	-0.96	0.47	0.72
Growth Avg	179	9.27	7.45	19.89	0.29	—
L+M 5 minus L+M 1	179	9.97	10.07	0.62	0.46	0.80
Core Avg	179	9.23	7.88	17.06	0.33	—
L+M 5 minus L+M 1	179	7.20	7.28	0.14	0.39	0.59
Value Avg	179	9.49	8.25	16.42	0.36	—
L+M 5 minus L+M 1	179	4.94	5.26	-1.74	0.32	0.50
All Avg	179	9.10	7.61	17.97	0.31	—
L+M 5 minus L+M 1	179	9.38	9.34	1.13	0.45	0.73

Table 5: Average Fund Size, Fund Turnover, and Fund Fees for the Five Combined Liquidity and Momentum Composites

L+M 1 = High Liquidity Low Momentum and L+M 5 = Low Liquidity High Momentum

	Fund Size	Fund Turnover %	Fund Fees %
All L+M 1	593.24	83.25	1.31
All L+M 2	987.80	66.93	1.08
All L+M 3	957.71	72.32	1.11
All L+M 4	816.45	84.65	1.17
All L+M 5	621.94	121.73	1.35

Liquidity and Momentum Composites

The results of Table 3 lead to a new question: Do composites of mutual funds with the two good attributes, that is, funds that simultaneously hold stocks with low liquidity and high momentum, do even better? To answer this question, we calculated two normalized z-scores for each fund—one based on the fund's weighted average liquidity score and one based on the fund's weighted average momentum score, where low liquidity and high momentum are deemed to be good.² The two normalized z-scores can then be added together to form a combined score. Funds are then assigned to quintiles based on the combined score, where the L+M 1 composite represents funds with high liquidity and low momentum and the L+M 5 composite represents funds with low liquidity and high momentum.

The results of combining liquidity and momentum are displayed in Table 4. The results are impressive and arguably significantly more compelling than the results of using liquidity or momentum in isolation. For each of the 16 groupings, the lowest-liquidity, highest-momentum composite (L+M 5) had a superior annual arithmetic return, annual geometric return, Sharpe ratio, and monthly alpha when compared with the applicable equally weighted composite for that category. For all 16 categories, the t-statistic of the monthly alpha exceeded 2, with an average across the 16 categories of 3.30. (See the original study results for each category quintile's statistics, including the t-statistic of the alphas.)

Focusing on the "All" composites at the bottom of Table 4, representing our entire universe of U.S.-equity funds, highlights the dominance of the low-liquidity, high-momentum composites over the high-liquidity, low-momentum composites. Comparing the All L+M 5 composites to the All L+M 1

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² A normalized z-score is calculated by subtracting the average raw score from each individual raw score—in our case, liquidity score or momentum score—divided by the standard deviation of the appropriate raw scores. It enables us to put liquidity scores and momentum scores on equal footing and then combine them in a manner that is not influenced by the dimension of either score.

Table 6: Monthly Up-side / Down-side Capture Statistics

U.S.-Equity Fund Universe (February 1995–December 2009)

M1 = Low Momentum and M5 = High Momentum, L+M 1 = High Liquidity Low Momentum and L+M 5 = Low Liquidity High Momentum

Momentum Composites	Up Periods ¹	Down Periods ¹	Avg Up Return % ²	Avg Down Return % ²	Avg Up Mkt Return ³	Avg Down Mkt Return ³	Up-Mkt Capture ⁴	Down-Mkt Capture ⁴
All M1	112	67	3.31	-4.35	3.12	-4.25	88.18	104.63
All M2	109	70	3.38	-3.72	3.21	-3.97	91.17	97.22
All M3	110	69	3.59	-3.83	3.45	-4.05	98.30	99.17
All M4	109	70	3.94	-3.95	3.73	-4.20	106.11	102.83
All M5	111	68	4.45	-4.59	4.22	-4.60	119.55	113.04
All M Avg	109	70	3.73	-3.95	3.55	-4.21	100.86	103.23
Combined Liquidity and Momentum Composites								
All L+M 1	106	73	3.68	-4.40	3.31	-4.75	93.65	116.94
All L+M 2	109	70	3.41	-3.82	3.24	-4.08	92.01	99.96
All L+M 3	110	69	3.55	-3.80	3.42	-4.03	97.28	98.55
All L+M 4	110	69	3.80	-3.83	3.64	-4.03	103.63	98.53
All L+M 5	111	68	4.33	-4.17	4.12	-4.19	116.94	102.73
All L+M Avg	109	70	3.73	-3.95	3.55	-4.21	100.87	103.19

composites, the annual geometric return was 9.34% higher and the Sharpe ratio was significantly better (0.51 versus 0.06). This superior performance came at a slightly higher risk level; the standard deviation of the All L+M 5 composite was 20.54% versus 19.42% for the All L+M 1 composite.

Additional fund characteristics for the five L+M composites are shown in Table 5. The fund size, turnover, and management fees are averaged across the composite and over the entire 14-year and 11-month period for all of the U.S. funds. The L+M 5 composite (with the lowest liquidity and highest momentum) has relatively smaller size, higher turnover, and higher management fees.

IXI (2010) showed that the superior performance of the low-liquidity composite was, surprisingly, the result of superior downmarket performance. Next, in Table 6 we analyze the upside, downside statistics of the momentum-only composites as well as

the combined liquidity momentum composites to gain insight into how value is added.

The superior performance of the All M5 composite, representing mutual funds that hold high-momentum stocks, is primarily because of better performance in up markets. This is consistent with Cooper, Gutierrez, and Hameed (2004), which shows that the momentum profit comes mainly from the up markets. While the downmarket capture statistic exceeds 100 by 13.04, indicating that the All M5 composite loses more money than the market during down markets, this is offset by an upmarket capture of 119.55.

The superior performance of the All L+M 5 composite, representing mutual funds that hold low-liquidity, high-momentum stocks, is also primarily because of better performance in up markets. In this case, the downmarket capture statistic exceeds 100 by only 2.73, indicating that the All L+M 5 composite loses only slightly more money than the market

during down markets, but this is more than offset by an upmarket capture of 116.94.

Conclusions

IXI (2010) showed that composites of mutual funds that held less-liquid stocks outperformed composites of mutual funds that held more-liquid stocks. This paper extends IXI (2010), which combined individual stock data with mutual fund holdings to build composites of mutual funds based on liquidity.

In this paper, we demonstrate that composites of mutual funds that hold stocks with high momentum outperform composites of mutual funds that hold stocks with low momentum. For each of the 16 groupings, the high-momentum composite (M5) had a superior annual arithmetic return, annual geometric return, Sharpe ratio, and monthly alpha when compared with the applicable equally weighted composite for that category.

Combining liquidity and momentum factors to build composites led to even more-compelling results. For each of the 16 groupings, the lowest-liquidity, highest-momentum composite (L+M5) had a superior annual arithmetic return, annual geometric return, Sharpe ratio, and monthly alpha when compared with the applicable equally weighted composite for that category. For all 16 categories, the t-statistic of the monthly alpha exceeded 2, with an average across the 16 categories of 3.30. ■■■

Please see the original study for a full list of references and acknowledgements.

¹ Up Periods and Down Periods simply report the total number of positive and negative monthly returns in the sample of 179 months.

² The Average Up Return and Average Down Return statistics report the average of all positive returns and all negative returns in the sample, respectively.

³ The Average Up Market Return and Average Down Market Return report similar statistics based on the performance of the "market," which in this case is defined as the Russell 3000.

⁴ The Up-Market Capture and Down-Market Capture report what percentage of the market's up and down movements are captured, respectively, where numbers greater than 100 indicate greater sensitivity to the Russell 3000.

Morningstar Product Spotlight: Morningstar Direct™

What is a hedge fund, and where can I find one?



by
Benjamin N. Alpert, CFA, CAIA
Research Analyst

In the United States, the definition of a hedge fund is pretty clear. They are private funds, claiming exemption from registration from the Securities Act of 1933 and the Investment Advisors/Investment Company Acts of 1940. While these private funds are not all the same, they do share common characteristics, such as a 2% management fee and 20% incentive fee structure (on average) and limited redemptions or withdrawals. But hedge funds are no longer a U.S. phenomenon, and as the managers cross borders, the traits that define and differentiate hedge funds become murkier. Furthermore, as managers have migrated to more-accessible and more-liquid vehicles, the definition becomes even grayer.

Historically, Morningstar's products, including Morningstar Direct™, have organized investments by vehicle in order to isolate investments for comparative purposes as well as to deliver information to various investment products and audiences. For example, funds in the U.S. open-end mutual fund database are

sold only to U.S. investors and are governed by different regulations than other U.S. pooled investment types such as closed-end funds. Morningstar rates and ranks U.S. open-end funds only against other open-end funds sold in the U.S. But as our clients—particularly institutional investors—have become more global, we are changing the way we think about our products, particularly our hedge fund database.

The Transformation of Hedge Funds

The original definition of a hedge fund probably comes from the term “hedged fund” popularized by a 1966 *Fortune* magazine article about money manager Alfred W. Jones. In 1949, Jones started a fund that bought stocks long and sold shares of other companies short to hedge market risk, and made use of leverage. The fund was structured as a limited partnership and limited the number of investors to avoid regulation. The fund also charged a 20% performance fee. Jones' fund and other private funds like his became synonymous with the term hedge fund over the next 30 years, although the strategies that they followed became more and more diverse.

Hedge funds failed to gain widespread acceptance, however, until after the tech bubble burst. During this period, hedged equity and other alternative strategies strongly outperformed long-only strategies. The Morningstar MSCI Composite Asset Weighted Hedge Fund Index gained almost 4%

between March 2000 and September 2002, while the S&P 500 Index lost 17%. This success influenced a large number of advisors, both U.S. and global, to explore using “hedged” or alternative investment strategies in legal structures outside of mutual funds, such as limited partnerships, commodity pools, and managed accounts.

Furthermore, in late 2001, the European Union adopted UCITS III. This regulatory framework greatly expanded the number of alternative strategies available within regulated investment vehicles, which were accessible to a much wider investor pool. Hedge funds launched UCITS III funds in droves in order to diversify and expand their asset base. A similar registered hedge fund wave came much later in the U.S., following the financial crisis of 2007–09. During the crisis, many hedge funds lost assets as their investors sought liquidity and as the managers posted large losses from excess leverage and illiquidity. Many of these same hedge fund managers launched their strategies in mutual funds to rebuild their asset base. Both the adoption of UCITS III and the recent financial crisis helped blur the line between hedge funds and mutual funds. Today, there are more than 1,100 European and 310 U.S. registered mutual funds (and at least as many U.S. exchange-traded funds) using alternative strategies that are available to any investor who can meet the investment minimum.

CONTINUED ON NEXT PAGE

Hedge Funds Across Domiciles

In order to create a global hedge fund definition, we compared and contrasted the characteristics of hedge funds across domiciles. See Table 1 for a summary.

Here are a few examples of how vastly the definition of hedge fund can vary depending on locale. In the Cayman Islands, the largest truly offshore domicile, most private funds must be registered by law, but there are no restrictions on investment policies. These funds cannot be marketed to investors who do not qualify as high-net-worth individuals or sophisticated investors under the law. In contrast, hedge funds in Sweden are not limited to wealthier investors and are therefore public, but many of these public hedge funds restrict redemptions. Luxembourg’s rules are much more complicated. Luxembourg fund regulation has three primary designations (Part I, Part II, and Part III). Part III funds are also called sophisticated investor funds with rules that parallel qualified investor rules around the world. ALFI, the local funds association, promotes the SIF structure as a regulated onshore hedge fund. Part II funds, however, allow for significant leverage (double that of UCITS funds), and some have less-frequent redemption policies. Luxembourg Part I funds are fully compliant with the pan-European UCITS regulations (now in their fourth iteration, UCITS IV) and fully marketed to all investors. Finally, in Ireland, Europe’s other major fund center, the qualified investor funds are most similar to U.S. hedge funds. QIFs can be marketed only to professional investors, as defined by their investment experience, work experience, or investable assets (EUR 500,000 minimum). Ireland has a second designation, termed Professional Investor Funds, which does not have a net-worth or sophistication test. These could be construed as hedge funds, however, as they have a EUR 125,000 minimum account size and sometimes infrequent redemptions.

Morningstar’s Definition of a Hedge Fund

Morningstar’s current hedge fund definition, first published in March 2011, formalizes

Table 1: Hedge Fund Characteristics Across Domiciles

Investment Trait	Feature of Hedge Funds Across Domiciles	Feature of Open-End, Closed-End, or ETFs Across Domiciles
Public access	Uncommon	Required
Marketing	Very limited, permitted in certain domiciles and structures	Fully permitted with regulated content for public dissemination
Hedges/shorts	Common	Some
Use of leverage	Common	Some, with limitations
Performance fee	Common	Some
High minimum investment	Common	Some
Infrequent redemptions	Common—monthly or quarterly	Uncommon
Pricing requirements	Uncommon	Daily with some exceptions
Redemption gates	Few regulations, but limited in certain structures	Rarely permitted

our view of what a hedge fund is across countries and legal structures. Our definition is based on the operational characteristics that differentiate hedge funds from other investment funds: a legal structure that allows for managers to restrict investors and negotiate terms (such as transparency, fees, and timing and size of subscriptions and redemptions), a qualification test that limits access to many investors (such as MiFID Annex II or U.S. accredited and qualified investor rules), and restrictive liquidity terms. Although the specifics of what defines a hedge fund vary across countries, these views are globally accepted. Hedge funds are considered speculative and not suitable for small, unsophisticated, novice investors in the main locales where they have historically been established. Furthermore, investors in public funds across locales expect a timely exit for their investment near the net asset value and are subject to standardized investment terms.

Morningstar’s hedge fund definition may cover different types of funds as the legislation governing them evolves. U.S. law distinguishing hedge funds from other investment structures has remained relatively stable over time. But many other countries have revised their laws recently and more frequently: The Cayman Islands’ regulations changed in 2011; Luxembourg’s SIF regulations were amended in 2011 to comply with the upcoming European Alternative Investment Funds Management

Directive; and other jurisdictions are expected to follow suit in order to market products across Europe. Morningstar’s products will continue to rate and rank hedge fund investments against other hedge funds as defined by Morningstar.

Where to Find a Hedge Fund in Morningstar’s Database

In Morningstar Direct, the hedge fund database is currently termed as such. Hedge funds are siloed by single manager versus fund of fund setups and are categorized by investment strategy (primarily long and short, but sometimes long-only). Based on Morningstar’s new definition of hedge funds, the hedge fund database will become more of a “qualified investor” database and will include some funds previously housed in the open-end database in various countries. The initial changes will be small. Luxembourg SIF funds, which until recently were placed in hedge fund or open-end based on a review of investment strategy, will all move to the new qualified investor database. Irish QIFs will also be added. All UCITS funds will remain together in our open-end fund database, as UCITS funds can be widely marketed and require a minimum of biweekly liquidity. In the end, the goal is to keep it simple, help all investors navigate the waters of various investment products, and compare like with like. ■■

Industry Trends: Alternative Mutual Funds

Record liquid alternative fund launches in 2011.



by
Nadia Papagiannis, CFA
Director of Alternative Fund Research

Alternative Mutual Funds

The numbers are in: 2011 was the biggest year yet for liquid alternative investments. Seventy-eight alternative mutual funds launched this year, compared with 55 in 2010, 28 in 2009, and 32 in 2008. In terms of assets, funds in Morningstar's seven alternative mutual fund categories grew by 23%. While that growth was less than the 83% experienced in 2010 and the 62% increase in 2009, it is still nothing to sniff at. At the end of October 2011, Morningstar introduced its latest alternative category, nontraditional bond, which brings together funds that hedge or short interest-rate or credit risk. This category, with only 38 constituents, is by far the largest alternative category in terms of assets, as advisors continue to shy away from U.S. equities (U.S. stock funds bled nearly \$75 billion in 2011) but want some downside protection. Twelve of the 38 funds launched in 2011, and four debuted in the last quarter, including Forward Global Credit Long/Short **FGCVX**, BlackRock Global Long/Short Credit **BGCAX**, Guggenheim Macro Opportunities **GIOAX**, and

Metropolitan West Unconstrained Bond **MWCIX**. The expense ratios for these offerings increase as the strategy becomes more complicated—between 0.75% and 2.99%.

The fourth quarter of 2011 was also a big one for fund launches in other alternative categories: Two currency funds, seven long/short equity funds, five managed-futures funds, three market-neutral funds, and 10 multi-alternative funds launched. In currencies, the trend is toward emerging-markets currencies, which may deliver the high yields that advisors seek with little duration risk. Eaton Vance Parametric Structured Currency **EAPSX**, offered at 0.90%, is one such fund.

In long/short equities, the trend is toward niche strategies, such as real estate (CBRE Clarion Long/Short **CLSIX**), commodities (Highland Energy and Materials **HEFAX**), and emerging markets (BlackRock Emerging Market Long/Short **BLSAX**). These focused funds hope to offer better risk-adjusted returns than the average diversified, U.S.-centric long/short stock fund, which lost 2.8% in 2011, relative to the S&P 500's 2.1% gain. This hope comes at a price, however—at least 2.0%.

In managed futures, the trend is also leaning away from the standard, diversified long-term momentum strategy. Altegris Futures Evolution **EVOAX** is a new multimanager fund where trend-following is only one component. TFS Capital recently launched an internally

managed long-short futures fund, TFS Hedged Futures **TFSHX**, that does not incorporate any trend following. Highland Alpha Trend Strategies Fund **HATAAX** and 361 Managed Futures Strategy **AMFOX** are sticking to trend-following with exchange-traded funds and futures contracts, but only on equity indexes. These newfangled strategies charge at least 2.25%.

Finally, as advisors struggle with asset allocation in a volatile macroeconomic environment, more multistrategy alternative funds are attempting to provide an answer. Surprisingly, the answers are coming from traditional mutual fund firms such as William Blair, which now offers William Blair Macro Allocation **WMCIX**, Neuberger Berman (Neuberger Berman Long Short **NLSAX**), and John Hancock (John Hancock Global Absolute Return Strategies **JHAAX**). These strategies are primarily asset-allocation strategies that involve some degree of hedging or shorting and charge at least 1.34%. Instead of outsourcing to relatively expensive mutual funds, some advisors are taking control by trading exchange-traded funds and notes. UBS E-TRACS recently launched Fisher-Gartman Risk Off **OFF** and Risk On **ONN**, which offer long and short exposure to baskets of risky assets (such as commodities, equities, and emerging-markets stocks and currencies) and safe-haven assets (such as developed-markets sovereign debt and currencies). ■■■

Fund Reports

Aspen Managed Futures Strategy

by **Terry Tian**

Advisor

Aspen Partners, LP

Advisor Location

Atlanta, Georgia

Assets Under Management

\$49.1 million (fund)

Inception Date

Aug. 2, 2011

Investment Type

Mutual fund

Morningstar Category

Managed futures

Management

Paul Morin and Ben Warwick are co-chief investment officers of Aspen Partners, which was founded in 1996. Paul Morin oversees the day-to-day operations of the mutual fund as well as the firm's multimanager hedge funds. Prior to joining Aspen in 2010, Morin served as director of research at 6800 Capital, a managed-futures hedge fund firm. Warwick, although not a named manager on the fund, is responsible for the construction and maintenance of the Aspen Managed Futures Beta Index, the index this passively managed mutual fund tracks. Prior to joining Aspen Partners in 2010, Warwick was chief investment officer of Sovereign Wealth Management, a multifamily wealth management firm. Warwick and Morin are supported by one trader and five analysts.

Strategy

This index-tracking mutual fund aims to capture the returns of a proprietary managed-futures index (the Aspen Managed Futures Beta Index), which follows a strategy that is at least 75% (of notional risk exposure) trend-following or momentum-based and up to 25% in a strategy that management labels as "counter-trend." Allocation to the two modules depends on the program's reading on the current volatility environment. The trend-following portion, which represents the main source of return for managed-futures funds, attempts to identify medium- to long-term (up to 12 months) price momentum in various futures contracts, taking long positions in upward-trending futures contracts and short positions in those exhibiting negative price trends. The counter-trend allocation serves as a hedge to the trend-following strategy, by taking long and short positions in futures contracts which tend to outperform in a low-volatility environment (as trend-following can work well in periods of high volatility). The overall portfolio is intended to exhibit low or negative correlations to other asset classes and targets an annualized standard deviation of 10% over a full market cycle.

Because futures contracts are leveraged, a small amount of the fund's assets are held as margin for futures contracts, while the remainder of the portfolio is invested in U.S. Treasuries. Management does not intend to take on credit risk with this collateral.

Process

The fund's systematic (automated) investment process trades in 23 liquid futures contract markets (roughly 20 in the trend-following module, and four to seven in the countertrend module, some of which overlap) in four asset-class buckets: equities, currencies, fixed income, and commodities. The trend-following strategy uses five different indicators, which measure price trends over five time periods. If all five measures point in the same (positive or negative) direction, the model directs the fund to overweight a particular futures contract (long or short) relative to its equal risk-weighted base position. Conversely, if the indicators conflict, the fund will reduce the long or short position size. All modules are updated on a weekly basis because management believes that more-frequent rebalancing enables the fund to react timely to new signals in the market. For the trend-following strategy, the fund attempts to equally weight contracts within each asset-class bucket. In order to determine allocation to the two strategies—trend-following versus counter-trend—management employs an algorithm with six volatility indicators to identify the current volatility regime and allocates to trend-following and countertrend strategies accordingly.

Risk Management

In order to mitigate downside risk, the fund weights contracts in the trend-following strategy by volatility, meaning that more-volatile assets (such as commodities) require smaller position sizes than less-volatile contracts (such as bond futures). Management equally weights the four broad asset classes—equities, fixed income, currencies, and commodities—as well as the futures contracts within each asset class. The weightings are rebalanced on a weekly basis to ensure that no single futures market contributes a disproportionate amount of risk to the fund. Besides risk weighting, management relies on the performance of the countertrend strategy (which management believes is uncorrelated to the trend-following component) to damp volatility in the fund. ■■

Aspen Managed Futures Strategy A (USD)

Standard Index
S&P 500 TR

Category Index
S&P Diversified
Trends Indicator TR

Morningstar Cat
US OE Managed
Futures

Performance 12-31-2011					
Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2009	—	—	—	—	—
2010	—	—	—	—	—
2011	—	—	—	-7.81	—
Trailing Returns					
	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	—	—	—	—	-11.83
Std 12-31-2011	—	—	—	—	-11.83
Total Return	—	—	—	—	-6.70
+/- Std Index	—	—	—	—	—
+/- Cat Index	—	—	—	—	—
% Rank Cat					
No. in Cat	—	—	—	—	—
7-day Yield					
—	—	—	—	—	—

Performance Disclosure

The Overall Morningstar Rating is based on risk-adjusted returns, derived from a weighted average of the three-, five-, and 10-year (if applicable) Morningstar metrics. The performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate; thus an investor's shares, when sold or redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please call 855-856-9444.

Fees and Expenses

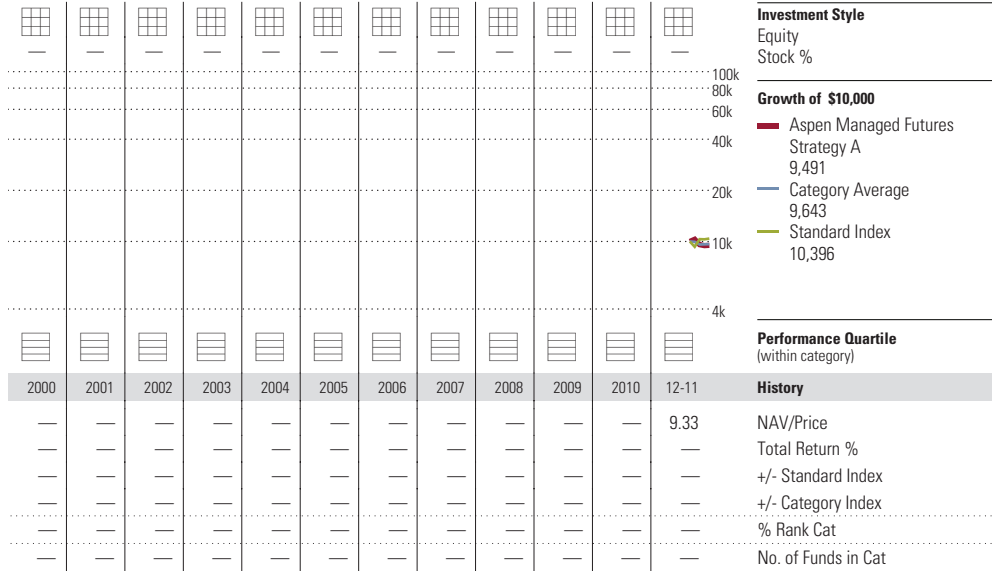
Sales Charges	
Front-End Load %	5.50
Deferred Load %	NA
Fund Expenses	
Management Fees %	0.75
12b1 Expense %	0.25
Gross Expense Ratio %	2.81
Prospectus Gross Expense Ratio %	2.81

Risk and Return Profile

	3 Yr	5 Yr	10 Yr
Morningstar Rating™	—	—	—
Morningstar Risk	—	—	—
Morningstar Return	—	—	—
MPT Statistics			
	Standard Index	Best Fit Index	
Alpha	—	—	—
Beta	—	—	—
R-Squared	—	—	—
12-Month Yield	—	—	—
30-day SEC Yield	—	—	—
Potential Cap Gains Exp	—	—	—

Operations

Family:	Financial Investors Trust (Aspen)	Base Currency:	USD	Incept:	08-02-2011
Manager:	Multiple	Ticker:	MFBPX	Type:	MF
Tenure:	0.4 Year	Minimum Initial Purchase:	\$2,500	Total Assets:	\$57.48 mil
Objective:	Growth	Purchase Constraints:	—		



Portfolio Analysis

Asset Allocation %	Net %	Long %	Short %	Share Chg since	Share Amount	Holdings: 0 Total Stocks, 0 Total Fixed-Income, — Turnover Ratio	% Net Assets
Cash	—	—	—	—	—	—	—
US Stocks	—	—	—	—	—	—	—
Non-US Stocks	—	—	—	—	—	—	—
Bonds	—	—	—	—	—	—	—
Other/Not Clsfd	—	—	—	—	—	—	—
Total	—	—	—	—	—	—	—

Equity Style	Portfolio Statistics	Port Avg	Rel Index	Rel Cat
Value Blend Growth	P/E Ratio TTM	—	—	—
Large Mid Small	P/C Ratio TTM	—	—	—
	P/B Ratio TTM	—	—	—
	Geo Avg Mkt Cap \$mil	—	—	—

Fixed-Income Style	Ltd	Mod	Ext	High	Mid	Low
Avg Eff Maturity	—	—	—	—	—	—
Avg Eff Duration	—	—	—	—	—	—
Avg Credit Quality	—	—	—	—	—	—
Avg Wtd Coupon	—	—	—	—	—	—

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

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

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

Fund Reports

Bandon Isolated Alpha Fixed Income

by **Josh Charney**

Advisor

Bandon Capital Management

Advisor Location

Portland, Oregon

Assets Under Management

\$25.0 million (fund)

Inception Date

Dec. 31, 2010

Investment Type

Mutual fund

Morningstar Category

Nontraditional bond

Management

Managing principal and chief investment officer William Woodruff founded Bandon Capital Management in 2007. Prior to Bandon, Woodruff spent four years as a portfolio manager for Beacon Investment Group's hedge funds and alternative investment products. Woodruff delegates the management of Bandon Isolated Alpha Fixed Income to two subadvisors, Logan Circle Partners and Dix Hills Partners. Andrew Kronschnabel manages Logan Circle Partners' allocation. Kronschnabel is a senior portfolio manager responsible for the firm's absolute return strategies. Joseph Baggett, CFA, founder and senior portfolio manager for Dix Hills Partners, directs that firm's allocation.

Strategy

Bandon Isolated Alpha Fixed Income employs two external subadvisors to run two distinct strategies, one focused only on credit selection and one focused only on interest-rate-timing. The two portfolios are roughly equal in notional value. The credit strategy focuses on U.S. credit fundamentals (across fixed-income sectors) while hedging out interest-rate exposure. Some bets are directional (long or short), while others are hedged or pair trades (long and short). Management also engages in special-situation closed-end fund or preferred stock trades. The interest-rate strategy seeks to profit in any interest-rate environment (rising or falling) by betting on high-grade sovereign debt (U.S., U.K., German, and Japanese 10-year bonds) and debt-instruments (futures, options, and swaps), while remaining in a duration band of between negative 5.0 and 5.0 years. The fund's directional interest-rate trades bet on whether interest rates will rise or fall, while the relative value trades attempt to profit from the flattening or steepening of the yield curve.

Process

Subadvisor Logan Circle Partners constructs the credit side of the portfolio using fundamental research from its team of 12 traders, 15 research analysts, and nine portfolio managers. The research analysts are organized into five sectors, each with a senior analyst and at least one analyst/junior analyst. Each analyst closely covers and builds cash flow models for roughly 25 companies. These bottom-up models, as well as top-down credit trends, help the portfolio managers make investment decisions. The traders also generate investment ideas, focusing their attention on supply and demand factors, dealer relationships, historical valuation trends, and new issues. Management prefers smaller debt issuances, as Logan Circle Partners believes it holds an informational advantage in trading these securities.

Dix Hills Partners utilizes a fully systematized (automated) process to construct the interest-rate portfolio. The models seek to predict interest-rate moves on a monthly basis using three types of indicators (in order of importance): macroeconomic (U.S. government statistics, for example), bond market yields/valuations, and momentum. The subadvisors' trading process is coordinated around the first Friday of each month, when government data are released and the models can be updated.

Risk Management

The two subadvisors each employ independent risk controls. Dix Hills' interest-rate strategy employs a stop loss, which triggers a portfolio liquidation in the event of a 4% monthly (cycle) loss. (Positions are reinitiated at the start of the next monthly cycle.) In 2008, the firm implemented a "gains trimming" strategy, in which they realize gains once they reach 4%–5% during the month. Logan Circle's risk-management strategy is less regimented. As each position moves, the firm will re-evaluate loss tolerance and selling criteria. The subadvisor's risk-management techniques are also dependent upon the intended holding period—positions with shorter life spans are subject to a tighter trading band, while longer-term positions have more flexibility. On the fund level, management targets near-equal weighting between the two funds and reviews the overall portfolio daily to ensure that the risk objectives (duration and credit quality) are maintained. ■■

Bandon Isolated Alpha Fixed Income A (USD)

Standard Index
BarCap US Agg Bond TR USD

Category Index
BarCap US Govt/Credit 5-10 Yr Bond TR USD

Morningstar Cat
US OE Nontraditional Bond

Performance 12-31-2011					
Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2009	—	—	—	—	—
2010	—	—	—	—	—
2011	-1.40	0.30	-1.42	2.36	-0.20
Trailing Returns					
	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	—	—	—	—	-5.94
Std 12-31-2011	—	—	—	—	-5.94
Total Return	-0.20	—	—	—	-0.20
+/- Std Index	-8.04	—	—	—	—
+/- Cat Index	-10.99	—	—	—	—
% Rank Cat	38	—	—	—	—
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.

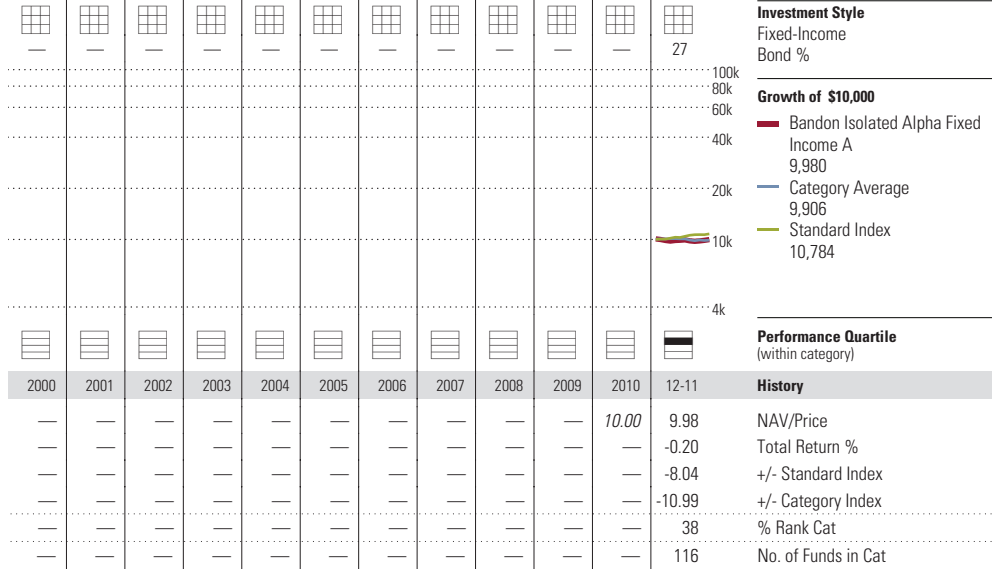
Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please call 855-477-8100.

Fees and Expenses

Sales Charges	
Front-End Load %	5.75
Deferred Load %	NA
Fund Expenses	
Management Fees %	1.75
12b1 Expense %	0.25
Gross Expense Ratio %	2.41
Prospectus Gross Expense Ratio %	2.41

Risk and Return Profile

	3 Yr	5 Yr	10 Yr
Morningstar Rating™	—	—	—
Morningstar Risk	—	—	—
Morningstar Return	—	—	—
	3 Yr	5 Yr	10 Yr
Standard Deviation	—	—	—
Mean	—	—	—
Sharpe Ratio	—	—	—
MPT Statistics			
	Standard Index	Best Fit Index	
Alpha	—	—	—
Beta	—	—	—
R-Squared	—	—	—
12-Month Yield	—	—	—
30-day SEC Yield	—	—	—
Potential Cap Gains Exp	—	1.15%	—



Portfolio Analysis 09-30-2011

Asset Allocation %	Net %	Long %	Short %	Share Chg since 06-2011	Share Amount	Holdings:	% Net Assets
Cash	65.11	65.11	0.00			1 Total Stocks, 44 Total Fixed-Income, 708% Turnover Ratio	
US Stocks	0.00	0.00	0.00				
Non-US Stocks	1.57	1.57	0.00	⊕	3 mil	HighMark Diversified Money Market	11.47
Bonds	26.44	26.54	0.11	⊙	1 mil	FHLBA 1.75%	3.83
Other/Not Clsfd	6.88	6.90	0.02	⊙	600,000	Mgm Resorts Intl 13%	2.59
Total	100.00	100.13	0.13	⊙	645,000	Intl Lease Fin 144A 6.5%	2.42
				⊙	300,000	United Kingdom (Government Of) 4.2	1.99
				⊙	5,975	Ameren III Pfd	1.77
				⊙	4,700	Peco Engy	1.57
				⊙	400,000	Sallie Mae 3.74%	1.51
				⊙	8,000	Carriage Svcs Cap Tr Pfd	1.35
				⊙	335,000	US Treasury Note 2.125%	1.28
				⊕	350,000	White Mtns Re Grp 144A FRN	1.21
				⊙	300,000	Fremf Mtg Tr 2011-K14 CMO	1.08
				⊙	275,000	Ontario Prov Cda 4%	1.07
				⊙	270,000	Bb&T Cap Tr I 5.85%	1.02
				⊙	2,645	Great Plains Engy Pfd	0.90

Equity Style

Value	Blend	Growth	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 Credit Quality	—	—	—	—	—
Avg Wtd Coupon	—	—	—	5.70	—

Credit Quality Breakdown

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

Regional Exposure

	Stock %	Rel Std Index
Americas	0.0	—
Greater Europe	100.0	—
Greater Asia	0.0	—

Sector Weightings

	Stocks %	Rel Std Index
Cyclical	0.0	—
Basic Materials	0.0	—
Consumer Cyclical	0.0	—
Financial Services	0.0	—
Real Estate	0.0	—
Sensitive	0.0	—
Communication Services	0.0	—
Energy	0.0	—
Industrials	0.0	—
Technology	0.0	—
Defensive	100.0	—
Consumer Defensive	0.0	—
Healthcare	0.0	—
Utilities	100.0	—

Operations

Family:	Bandon Capital Management, LLC
Manager:	Multiple
Tenure:	1.1 Years
Objective:	Income
Base Currency:	USD

Ticker:	BANAX
Minimum Initial Purchase:	\$10,000
Min Auto Investment Plan:	\$10,000
Minimum IRA Purchase:	\$1,000
Purchase Constraints:	—

Incept:	12-31-2010
Type:	MF
Total Assets:	\$25.01 mil

Fund Reports

Kinetics Multi-Disciplinary Advisor

by **Terry Tian**

Advisor

Horizon Kinetics LLC

Advisor Location

New York, New York

Assets Under Management

\$23.7 million (fund)

Inception Date

Feb. 11, 2008

Investment Type

Mutual fund

Morningstar Category

Conservative allocation

Management

Murray Stahl and David Kingsley are the lead portfolio managers of the fund. Stahl co-founded Horizon Asset Management in 1994 and serves as Horizon Kinetics' (the consolidated parent company) chairman of the board and chief investment officer. Prior to Horizon, Stahl worked at Bankers Trust Company for 16 years as a research analyst and senior portfolio manager. Kingsley joined the firm in 2006 and manages the firm's private credit funds. Derek Devens and Peter Doyle serve as supporting portfolio managers. Devens has fixed-income portfolio management experience, and Doyle is a co-founder and senior member of Horizon Kinetics' 17-person equity research team (including the portfolio managers).

Strategy

This fund employs a fully collateralized equity put-option-writing strategy and targets equitylike returns with damped volatility. Theoretically, a cash-collateralized put-writing strategy delivers a similar hedged equity payoff to covered-call writing. But because put options are generally more expensive than call options (investors pay up for downside protection and tend to overestimate future volatility in distressed times), management believes that put writing is more optimal than call writing. The fund writes put options on approximately 100 stocks (sometimes with multiple puts on one stock) and holds 20–30 bonds. Management invests its cash collateral in U.S. corporate bonds rated B– or better with durations of as much as five years to enhance the put-writing strategy's return.

Management sells primarily at-the-money puts on stocks within the coverage universe of the firm's fundamental equity research team. The fund profits from premiums collected on expired put contracts (if stock prices remain flat or rise). If stock prices fall and the options are executed, the fund is obligated to buy the underlying stock at higher-than-market-price using its collateral, which generates a loss. Because the collected premiums may offset these losses, management believes it stands to lose less than holding the underlying stocks. (The fund also stands to gain less, however.) Management may also write put options on sector or regional exchange-traded funds if options on stocks within these sectors or regions offer unattractive premiums or if the research team lacks a view on these stocks.

Process

The put-writing process starts with bottom-up research to identify stocks with strong fundamentals trading at deep discounts, based upon a three- to five-year outlook. (The same fundamental research drives the firm's flagship fund, Kinetics Paradigm Fund **WWNPX**.) Comanagers Peter Doyle and David Kingsley then evaluate put options on these stocks based upon the stock's perceived risk and the option's premium. The written put options are typically held to expiration, which ranges from three to 18 months (six months on average). If the underlying stock prices rise sharply and the value of the original put option collapses, management may buy back the worthless options and rewrite new at-the-money puts. If any options are executed (or the underlying stocks are "put back" to the fund), management will sell the purchased stocks immediately and simultaneously rewrite new at-the-money put options on the same names, as long as the original fundamental view holds. In selecting the bond holdings, management focuses on factors such as bond liquidity, pricing, and company balance-sheet strength. Bonds are typically held to maturity.

Risk Management

The fund is fully collateralized, meaning that the notional value of the put options will not exceed the fund's total net asset value. Management also limits single-name option exposure, or maximum loss, to approximately 1% of the fund's total assets. In order to diversify company-specific risk, the strategy avoids holding bonds of the same companies on which it writes put options. Management does not seek to time the stock market or interest-rate movements. Instead, turnover is mostly driven by option expiration and bond maturity. Management also monitors sector concentration and risk contribution from bonds and options on a regular basis. ■■■

Kinetics Multi-Disciplinary Advisor A (USD)

Overall Morningstar Rtg™
★★★
 548 US OE Conservative Allocation

Standard Index
 Morningstar
 Moderate Target Risk

Category Index
 Morningstar
 Moderately Cons Target Risk

Morningstar Cat
 US OE Conservative Allocation

Performance 12-31-2011

Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2009	-0.73	10.20	6.58	5.27	22.73
2010	3.36	-3.26	7.64	4.66	12.64
2011	5.27	1.00	-12.33	7.27	-0.01

Trailing Returns	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	-5.76	9.21	—	—	1.72
Std 12-31-2011	-5.76	—	—	—	1.72
Total Return	-0.01	11.39	—	—	3.28

+/- Std Index	-0.60	0.17	—	—	—
+/- Cat Index	-2.61	2.33	—	—	—

% Rank Cat	78	36	—	—	—
No. in Cat	610	548	—	—	—

7-day Yield

Performance Disclosure

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

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

Current performance may be lower or higher than return data quoted herein. For performance data current to the most recent month-end, please call 800-930-3828 or visit www.kineticsfunds.com.

Fees and Expenses

Sales Charges

Front-End Load %	5.75
Deferred Load %	NA

Fund Expenses

Management Fees %	1.25
12b1 Expense %	0.50
Gross Expense Ratio %	6.63
Prospectus Gross Expense Ratio %	6.63

Risk and Return Profile

	3 Yr	5 Yr	10 Yr
Morningstar Rating™	3★	—	—
Morningstar Risk	+Avg	—	—
Morningstar Return	Avg	—	—

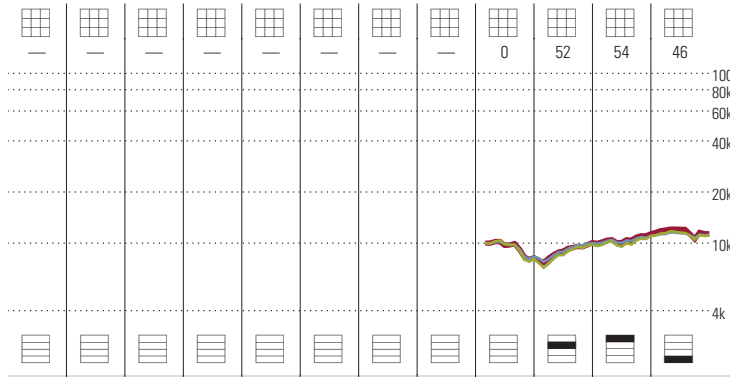
	3 Yr	5 Yr	10 Yr
Standard Deviation	11.02	—	—
Mean	11.39	—	—
Sharpe Ratio	1.03	—	—

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

12-Month Yield	—
30-day SEC Yield	—
Potential Cap Gains Exp	-2.07%

Operations

Family:	Kinetics
Manager:	Multiple
Tenure:	3.9 Years
Objective:	Income
Base Currency:	USD



Investment Style
 Fixed-Income Bond %

Growth of \$10,000

- Kinetics Multi-Disciplinary Advisor A: 11,338
- Category Average: 11,199
- Standard Index: 11,072

Performance Quartile
 (within category)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	12-11	History
NAV/Price	—	—	—	—	—	—	—	—	8.20	9.85	10.44	10.05	NAV/Price
Total Return %	—	—	—	—	—	—	—	—	—	22.73	12.64	-0.01	Total Return %
+/- Standard Index	—	—	—	—	—	—	—	—	—	0.95	0.30	-0.60	+/- Standard Index
+/- Category Index	—	—	—	—	—	—	—	—	—	7.41	2.98	-2.61	+/- Category Index
% Rank Cat	—	—	—	—	—	—	—	—	—	32	13	78	% Rank Cat
No. of Funds in Cat	—	—	—	—	—	—	—	—	—	628	656	610	No. of Funds in Cat

Portfolio Analysis 09-30-2011

Asset Allocation %	Net %	Long %	Short %
Cash	19.25	19.25	0.00
US Stocks	0.00	0.00	0.00
Non-US Stocks	14.99	14.99	0.00
Bonds	46.03	46.03	0.00
Other/Not Clsfd	19.74	19.74	0.00
Total	100.00	100.00	0.00

Share since 06-2011	Share Amount	Holdings:	% Net Assets
—	—	271 Total Stocks, 20 Total Fixed-Income, 38% Turnover Ratio	—
✱	2 mil	Owens-Brockway Glass Container 144	7.75
⊕	2 mil	Chesapeake Engy Cv 2.25%	7.68
—	2 mil	Consol Engy 8%	7.21
—	1 mil	Icahn Enterprises Lp/Corp Cv FRN	6.29
—	1 mil	Calpine Constr Fin Co L P / 8%	4.72
—	2 mil	Branson Mo Regl Arpt Transn De Rev	4.11
⊕	910,000	Davita 6.375%	4.01
—	830,000	Harvest Operations 7.5%	3.73
✱	800,000	Live Nation Entrtnmt Cv 2.875%	3.31
✱	740,000	Arcan Res 6.25%	3.15
—	2 mil	Branson Mo Regl Arpt Transn De Rev	3.08
—	590,000	Rouse 5.375%	2.69
—	250,000	Peabody Engy 6.5%	1.21
—	250,000	Sabine Pass Lng L P 7.25%	1.11
—	220,000	Corrections Corp Amer New 7.75%	1.07

Equity Style	Portfolio Statistics	Port Avg	Rel Index	Rel Cat
Value	P/E Ratio TTM	—	—	—
Blend	P/C Ratio TTM	—	—	—
Growth	P/B Ratio TTM	—	—	—
Large	Geo Avg Mkt Cap \$mil	—	—	—
Mid				
Small				

Fixed-Income Style	Portfolio Statistics	Port Avg	Rel Index	Rel Cat
Ltd	Avg Eff Maturity	—	—	—
Mod	Avg Eff Duration	—	—	—
Ext	Avg Credit Quality	—	—	—
High	Avg Wtd Coupon	—	5.32	—
Med				
Low				

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

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

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

Fund Reports

Robeco Boston Partners Long-Short Research

by **Mallory Horejs**

Advisor

Robeco Investment Management Inc.

Advisor Location

New York, New York

Assets Under Management

\$97.2 million (fund)

Inception Date

Sept. 30, 2010

Investment Type

Mutual fund

Morningstar Category

Long-short equity

Management

Co-portfolio managers Joseph Feeney and Eric Connerly run this fund, although a team of senior analysts is responsible for stock-picking and sector allocations. Feeney serves as Robeco Boston Partners' chief investment officer. In 2003, Robeco Investment Management acquired Boston Partners, a value equity manager founded in 1995. Feeney started with Boston Partners in 1995 and oversees the firm's fundamental and quantitative research groups. Connerly serves as the firm's director of research and also supports the Robeco Boston Partners 130/30 Large Cap Value strategy, which is available as a separate account.

Strategy

This long-short equity fund combines fundamental, bottom-up research with quantitative screening to identify undervalued and overvalued stocks across market capitalization. This offering differs from the firm's flagship Robeco Long/Short Equity **BPLSX** in that it is run by a different set of analysts who drives the investment decisions. The analysts are organized into seven distinct sectors, and each sector's senior analyst selects stocks within his or her sector. The portfolio is divided into eight approximately equal-weighted sleeves, one for each of the seven sectors, plus one that tests the best ideas of the junior analysts. The research analysts have autonomy over their respective sleeves, but Feeney and Connerly monitor the fund's aggregate-level exposures. Each portfolio segment contains roughly 15–30 long and 15–30 short positions, while the overall portfolio holds 200–400 positions. Gross long exposure in the portfolio ranges from 80% to 100% of assets, but the short side remains more market-dependent and can range from 30% to 60%. The fund's net long equity exposure is currently 60% (as of December 2011) and typically bounces between 40% and 60%. The fund's beta to the S&P 500 since inception is 0.62 (using weekly data through Dec. 31, 2011), slightly above management's targeted range of 0.25 to 0.50. Management seeks to outperform the S&P 500 Index by 300 basis points on the long side and create 300 basis points of value on the short side. The shorts are primarily small- and mid-capitalization stocks.

Process

When sourcing long positions, analysts begin with quantitative screens that rank all companies with a minimum \$50 million market capitalization based on a composite score of three factors: valuation, momentum, and fundamentals. This screen is used to aid in portfolio construction and idea generation. Analysts evaluate the quantitative rankings and conduct in-depth fundamental analysis on attractive candidates by creating internal valuation models, conducting on-site visits, and reviewing third-party research. Analysts favor stocks with attractive prices, strong business fundamentals (sales and earnings growth, for example), and positive price change catalysts (upward trends in profit margins, for example). Long positions are sold if price targets are reached, if fundamentals weaken, or if catalysts reverse. To identify short positions, analysts use focused screens to target companies with valuation risks (high price multiples, for example), earnings risks (flat or falling earnings estimates, for example), and balance-sheet risks (high debt and low cash levels, for example). Position sizes are determined by the degree of upside potential, the analyst's conviction level, and liquidity.

Risk Management

Although senior analysts are responsible for security selection and portfolio allocation, Feeney and Connerly manage risk at the portfolio level. They meet with the investment team formally twice a week to discuss investment candidates and current holdings. Management generally equal-weights each of the seven sector sleeves but will initially underweight when a new senior analyst is appointed. The allocations are rebalanced as needed, typically around cash flows. Overall industry sector weights are capped at 30% of the portfolio, while individual long and short positions are capped at 5% and 3% of assets, respectively. Management may also hedge the fund's overall net equity exposure using exchange-traded funds (most notable was a decrease in net market position in the second half of 2007). They do so infrequently, however. ■■

Robeco Boston Partners L/S Rsrch Instl (USD)

Standard Index
S&P 500 TR

Category Index
Russell 1000 TR
USD

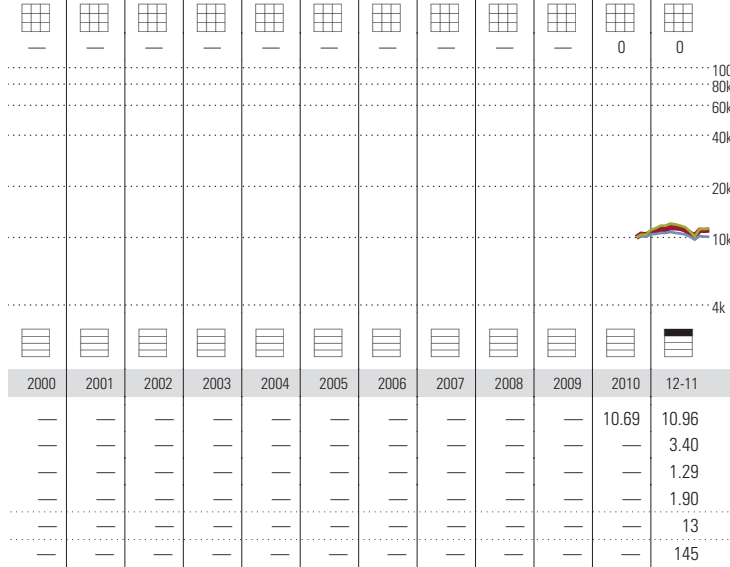
Morningstar Cat
US OE Long/Short
Equity

Performance 12-31-2011					
Quarterly Returns	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total %
2009	—	—	—	—	—
2010	—	—	—	6.90	—
2011	4.49	1.34	-9.89	8.37	3.40
Trailing Returns					
	1 Yr	3 Yr	5 Yr	10 Yr	Incept
Load-adj Mthly	3.40	—	—	—	8.34
Std 12-31-2011	3.40	—	—	—	8.34
Total Return	3.40	—	—	—	8.34
+/- Std Index	1.29	—	—	—	—
+/- Cat Index	1.90	—	—	—	—
% Rank Cat	13	—	—	—	—
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 888-261-4073 or visit www.robecoinvest.com.

Fees and Expenses	
Sales Charges	
Front-End Load %	NA
Deferred Load %	NA
Fund Expenses	
Management Fees %	1.25
12b1 Expense %	NA
Gross Expense Ratio %	3.36
Prospectus Gross Expense Ratio %	3.36

Risk and Return Profile			
	3 Yr	5 Yr	10 Yr
Morningstar Rating™	—	—	—
Morningstar Risk	—	—	—
Morningstar Return	—	—	—
	3 Yr	5 Yr	10 Yr
Standard Deviation	—	—	—
Mean	—	—	—
Sharpe Ratio	—	—	—
MPT Statistics	Standard Index	Best Fit Index	
Alpha	—	—	—
Beta	—	—	—
R-Squared	—	—	—
12-Month Yield	—	—	—
30-day SEC Yield	—	—	—
Potential Cap Gains Exp	—	—	0.78%



Investment Style	
Fixed-Income	11,054
Bond %	—
Growth of \$10,000	
Robeco Boston Partners L/S Rsrch Instl	11,054
Category Average	10,091
Standard Index	11,310
Performance Quartile (within category)	
History	
NAV/Price	10.96
Total Return %	3.40
+/- Standard Index	1.29
+/- Category Index	1.90
% Rank Cat	13
No. of Funds in Cat	145

Portfolio Analysis 09-30-2011

Asset Allocation %	Net %	Long %	Short %	Share Chg since 06-2011	Share Amount	Holdings:	% Net Assets
Cash	13.04	13.40	0.36			368 Total Stocks, 0 Total Fixed-Income, 61% Turnover Ratio	
US Stocks	77.18	119.10	41.92				
Non-US Stocks	10.56	19.19	8.63	✳	5 mil	Pnc Bank Money Market	11.49
Bonds	0.00	0.00	0.00	⊕	28,883	Wells Fargo & Co	1.70
Other/Not Clsfd	-0.78	0.00	0.78	⊕	38,590	Ingram Micro, Inc.	1.52
Total	100.00	151.68	51.68	⊕	24,905	Microsoft Corporation	1.51
				⊕	21,452	Oracle Corporation	1.50
				✳	1,615	Apple, Inc.	1.50
				⊕	20,357	JPMorgan Chase & Co	1.50
				⊕	14,100	Tyco International Ltd	1.40
				⊕	27,287	EMC Corporation	1.40
				⊕	9,285	SM Energy Co	1.37
				⊕	13,410	McGraw-Hill Companies, Inc.	1.34
				⊕	21,030	Raymond James Financial, Inc.	1.33
				⊕	12,425	Honeywell International, Inc.	1.33
				⊕	20,621	Citigroup Inc	1.29
				⊕	22,095	U.S. Bancorp	1.27

Equity Style			
Value	Blend	Growth	Rel Cat
Large	Small	Mid	Small
P/E Ratio TTM	11.6	0.85	0.86
P/C Ratio TTM	7.6	0.90	0.86
P/B Ratio TTM	1.4	0.69	0.65
Geo Avg Mkt Cap \$mil	10827	0.23	0.32

Fixed-Income Style			
Ltd	Mod	Ext	Rel Cat
High	Med	Low	High
Avg Eff Maturity	—	—	—
Avg Eff Duration	—	—	—
Avg Credit Quality	—	—	—
Avg Wtd Coupon	—	—	—

Credit Quality Breakdown		Bond %
AAA	—	—
AA	—	—
A	—	—
BBB	—	—
BB	—	—
B	—	—
Below B	—	—
NR/NA	—	—
Regional Exposure		Stock %
Americas	88.5	0.89
Greater Europe	9.4	103.74
Greater Asia	2.0	—

Sector Weightings	Stocks %	Rel Std Index
Cyclical	36.1	1.35
Basic Materials	2.3	0.70
Consumer Cyclical	13.5	1.44
Financial Services	20.3	1.64
Real Estate	0.0	0.00
Sensitive	44.0	0.95
Communication Services	4.1	0.96
Energy	4.8	0.39
Industrials	16.4	1.41
Technology	18.7	1.04
Defensive	19.9	0.74
Consumer Defensive	9.2	0.77
Healthcare	10.1	0.88
Utilities	0.6	0.16

Operations			
Family:	Robeco Investment Funds	Ticker:	BPIRX
Manager:	Multiple	Minimum Initial Purchase:	\$100,000
Tenure:	1.3 Years	Min Auto Investment Plan:	\$100,000
Objective:	Growth and Income	Minimum IRA Purchase:	\$100,000
Base Currency:	USD	Purchase Constraints:	A
		Incept:	09-30-2010
		Type:	MF
		Total Assets:	\$97.22 mil

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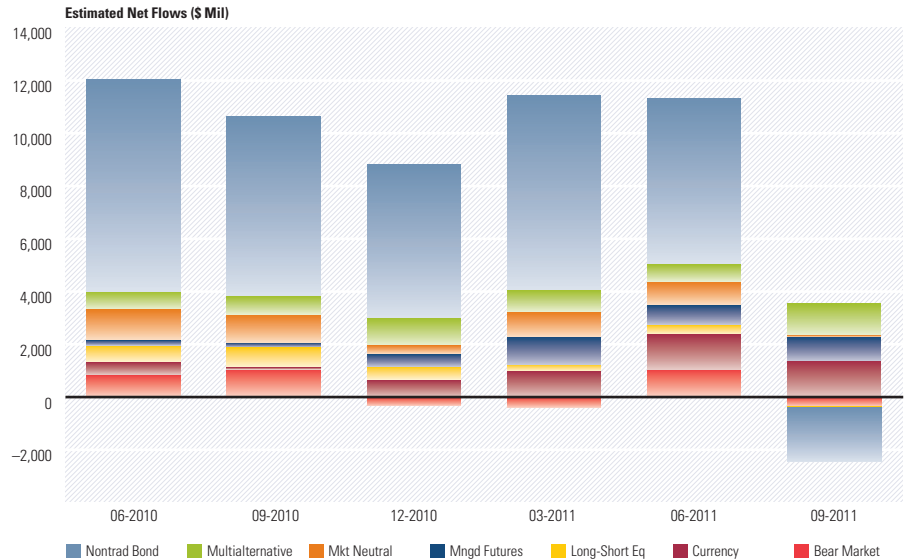


Flows and Assets Under Management: Alternative Mutual Funds

Quarterly Alternative Mutual Fund Flows

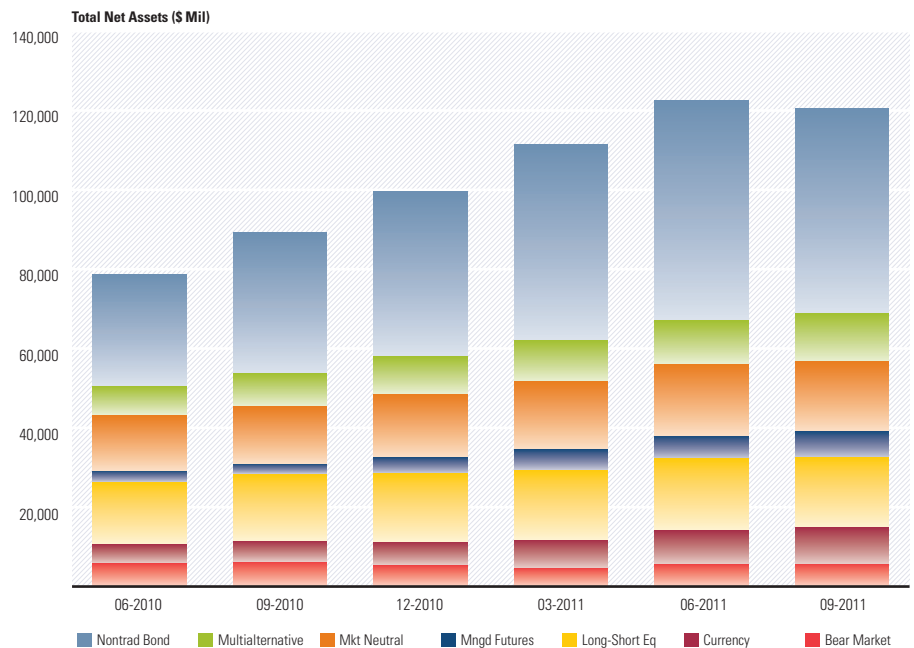
During the third quarter of 2011, alternative mutual funds experienced inflows of \$1.1 billion, a significant decrease of 90% from the previous quarter. This was largely the result of net outflows from the new non-traditional-bond category, which lost \$2.1 billion after several quarters of significant inflows. Two other alternative mutual fund categories, bear market and long-short equity, exhibited net outflows during the third quarter, of \$357 million and \$30 million, respectively. Funds in the currency and multialternative categories saw the largest net inflows, of \$1.4 billion and \$1.2 billion, respectively.

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



Quarterly Alternative Mutual Fund Assets Under Management

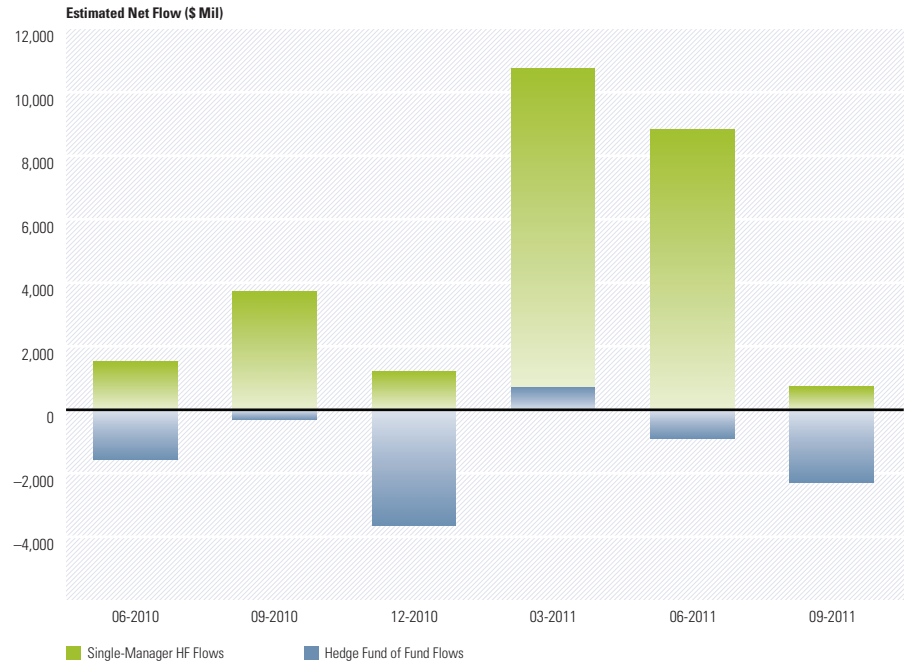
Assets under management of all alternative mutual funds fell by 1.7% during the third quarter of 2011 to \$120.5 billion. (Collectively, alternative mutual funds represent about 1.6% of total mutual fund assets.) Four of the seven alternative mutual fund categories gained assets during the third quarter, however. Assets in managed futures and multialternative funds rose the most, approximately 14.5% and 11.4%, respectively, because of inflows. The non-traditional-bond category saw its assets fall the most during the quarter (7.1%), but total assets remain the highest of all the alternative mutual fund categories, at \$51.4 billion as of Sept. 30, 2011.



Flows and Assets Under Management: Hedge Funds

Quarterly Hedge Fund Flows

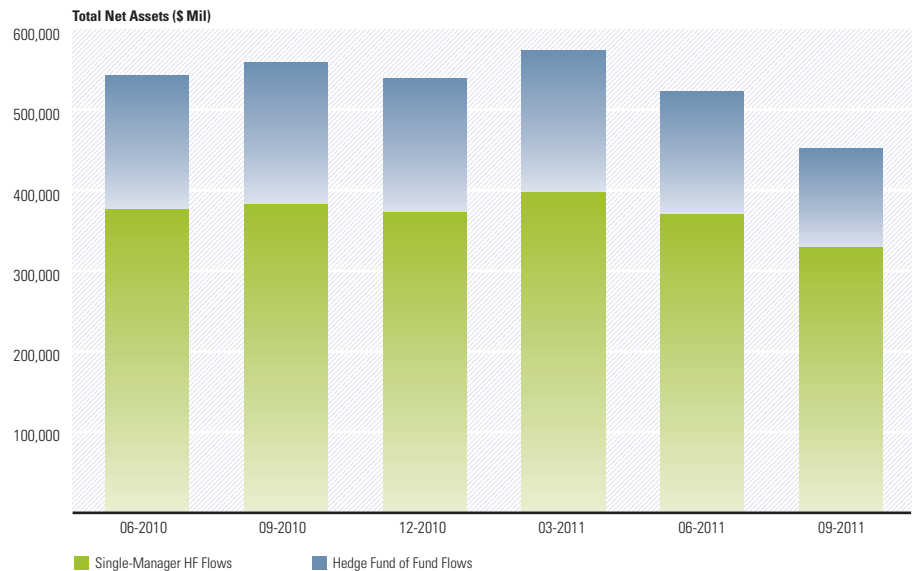
During the third quarter of 2011, single-manager hedge funds in Morningstar's database experienced inflows of \$721.6 million, and hedge funds of funds in Morningstar's database experienced outflows of \$2.3 billion. Diversified arbitrage and systematic futures hedge fund categories experienced the largest inflows: \$956.6 million and \$887.2 million, respectively. U.S. long-short equity and event-driven hedge funds in the database bled more than any other category during the quarter (\$876.2 million and \$369.5 million, respectively).



Quarterly Hedge Fund Assets Under Management

Single-manager hedge fund assets in Morningstar's database decreased 14.8% during the third quarter. Year-over-year (as of Sept. 30, 2011), assets under management of single-manager hedge funds fell by 17.0%. Hedge funds of funds within Morningstar's database manage 13.9% fewer assets than in the previous quarter and 22.0% less than one year ago.

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

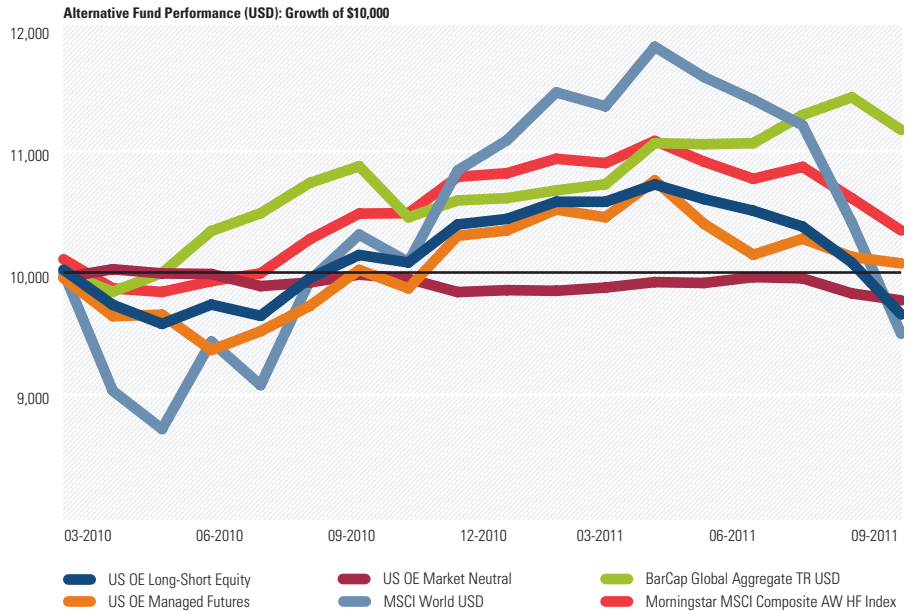


Alternative Investment Performance

Growth of a \$10,000 Alternative Investment

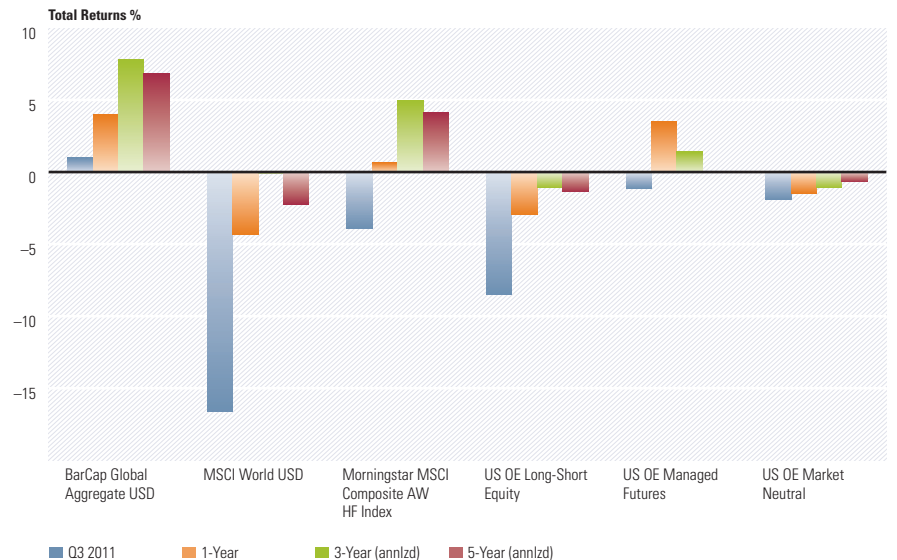
Hedge funds, as proxied by the Morningstar MSCI Composite AW Hedge Fund Index, lost 3.9% in the third quarter, while global stocks, as represented by the MSCI World NR Index, plunged 16.6%. The MSCI World NR Index fell by 5.0% in the 18 months ended Sept. 30, while the Morningstar MSCI Composite AW Hedge Fund Index increased by 3.4%. Although managed-futures mutual funds outperformed the average hedge fund during the third quarter, hedge funds in Morningstar's database have substantially outpaced alternative mutual funds in the past 18 months.

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



Performance of Alternative Investments Over Time

Global stocks (as represented by the MSCI World NR Index) performed significantly worse than the average hedge fund (per the Morningstar MSCI Composite AW Hedge Fund Index) in the quarter ended Sept. 30, 2011. Hedge funds have also provided better returns than equities have during the past three and five years. Global bonds have fared even better than both stocks and hedge funds have over these longer-term periods, and the BarCap Global Aggregate Bond Index experienced a gain of 1.0% in the third quarter of 2011. Three alternative mutual fund categories (long-short equity, managed futures, and market-neutral) underperformed against hedge funds over the three-year period ended Sept. 30, 2011.

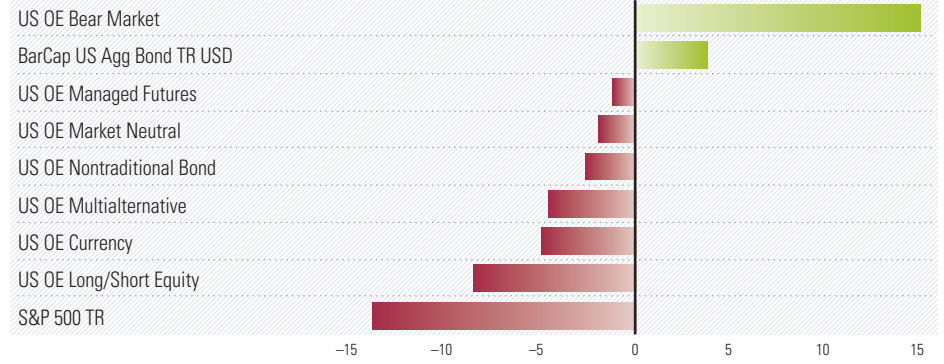


Q3 Performance by Category

Alternative Mutual Funds

The average managed-futures mutual fund lost 1.1% in the third quarter of 2011. The average bear-market fund surged 15.2%, in contrast to the S&P 500's 13.9% plunge. Long-short equity mutual funds outperformed the broad stock market, incurring an 8.5% loss on average. Currency mutual funds fell 4.9% on average for the quarter ended Sept. 30, 2011, as the U.S. dollar appreciated.

Morningstar Alternative Mutual Fund Category Averages: Q3 2011 Total Returns %

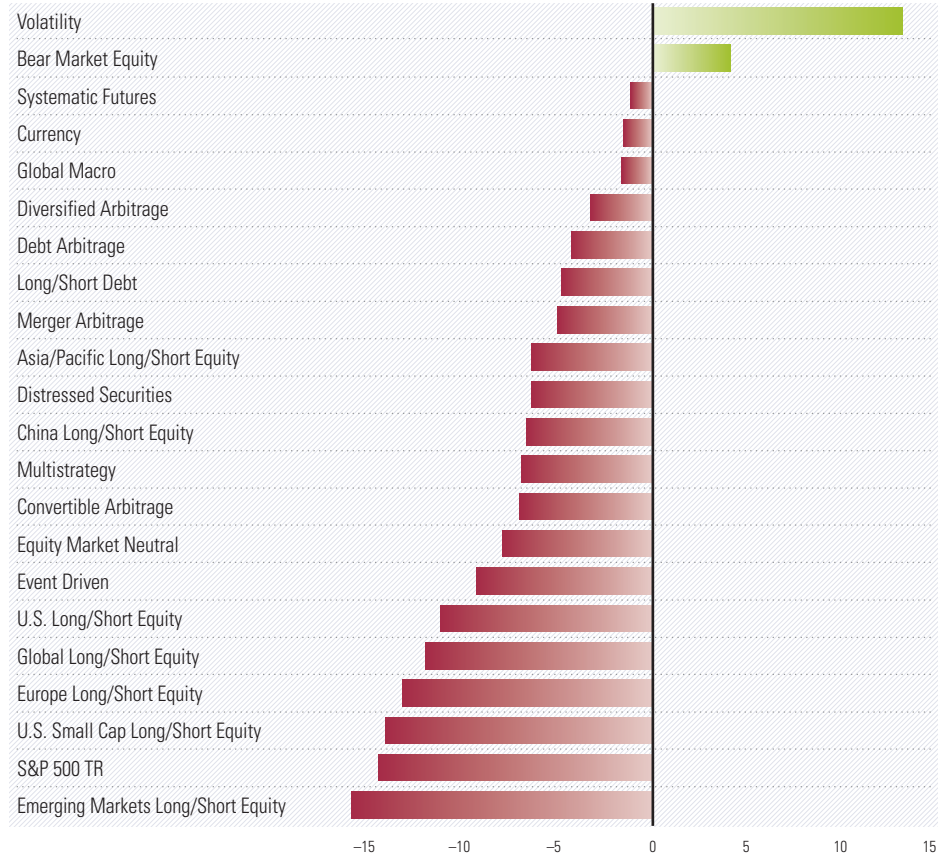


Hedge Funds

In the third quarter of 2011, there were both big winners and big losers among the hedge fund categories. The biggest losers were funds in the emerging-markets long-short equity and U.S. small-cap long-short equity categories, which lost 15.2% and 13.6% on average, respectively. Funds in the Morningstar volatility and bear-market equity categories increased the most, 12.7% and 3.9%, respectively, on average. The S&P 500 Index fell 13.9% during the quarter.

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

Morningstar Hedge Fund Category Averages: Q3 2011 Total Returns %

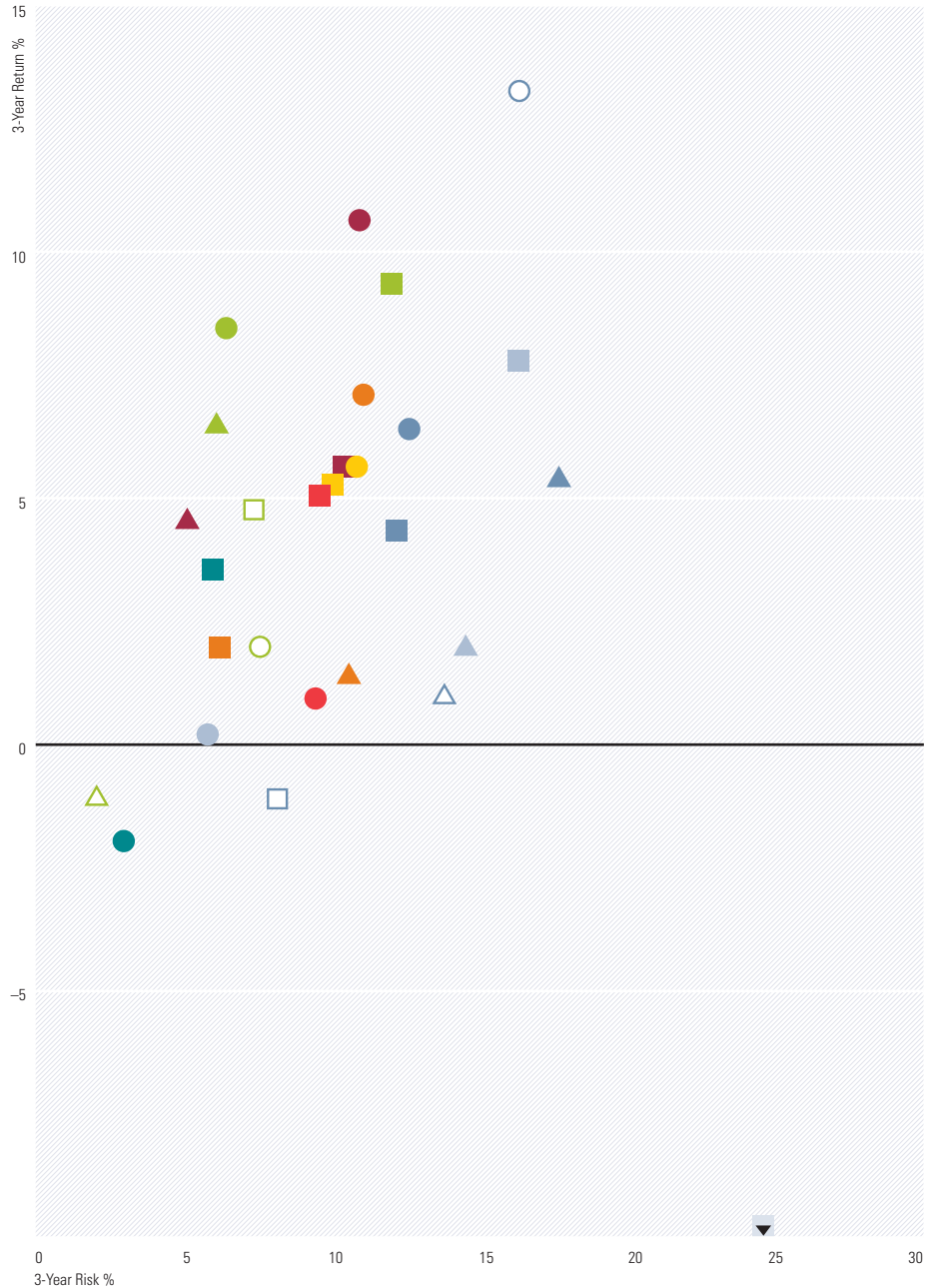


Risk Versus Return: Alternative Mutual Funds and Hedge Funds

Three-Year Standard Deviation and Return

Of Morningstar's 28 alternative mutual fund and hedge fund category averages, 24 exhibited positive returns over the three years ended September 2011. Funds in the China long-short equity and volatility hedge fund categories showed the best three-year total returns on average, 13.3% and 10.7%, respectively. In terms of risk-adjusted returns, however, diversified arbitrage and merger arbitrage hedge funds produced the best results on average during the past three-year period. In contrast, funds in the U.S. bear-market mutual fund category saw a 19.6% decline on average in the three-year period ended September 2011, with the highest standard deviation of all alternative mutual fund and hedge fund categories (24.6% annualized). The average currency mutual fund also exhibited a poor three-year risk-adjusted return profile, losing 2.0% with a 2.9% annualized standard deviation.

3-Year Risk Return % by Category or Strategy

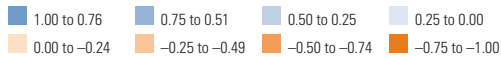


- Asia/Pacific Long/Short Equity
- Bear Market Equity
- China Long/Short Equity
- ▲ Emg Markets Long/Short Equity
- ▲ Europe Long/Short Equity
- ▲ Global Long/Short Equity
- U.S. Long/Short Equity
- U.S. Small Cap Long/Short Equity
- U.S. OE Bear Market
- U.S. OE Long/Short Equity
- Convertible Arbitrage
- Debt Arbitrage
- Diversified Arbitrage
- Equity Market Neutral
- ▲ Merger Arbitrage
- ▲ U.S. OE Market Neutral
- Currency
- U.S. OE Currency
- Distressed Securities
- Event Driven
- Global Macro
- Systematic Futures
- ▲ U.S. OE Managed Futures
- Long/Short Debt
- Volatility
- ▲ U.S. OE Non-traditional Bond
- Multistrategy
- U.S. OE Multialternative

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	-0.60	1.00					
3 US OE Long/Short Equity	-0.94	0.66	1.00				
4 US OE Managed Futures	0.15	0.24	-0.14	1.00			
5 US OE Market Neutral	-0.06	0.23	0.18	0.04	1.00		
6 US OE Multialternative	-0.94	0.57	0.97	-0.19	0.05	1.00	
7 US OE Nontraditional Bond	-0.67	0.38	0.80	-0.38	0.08	0.82	1.00

Three-Year Correlations: Hedge Fund Category Averages	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	
1 Asia/Pacific Long/Short Equity	1.00																					
2 Bear Market Equity	-0.32	1.00																				
3 China Long/Short Equity	0.41	-0.37	1.00																			
4 Convertible Arbitrage	0.77	-0.41	0.55	1.00																		
5 Currency	0.63	-0.05	0.26	0.41	1.00																	
6 Debt Arbitrage	0.79	-0.40	0.47	0.94	0.51	1.00																
7 Distressed Securities	0.74	-0.46	0.34	0.82	0.39	0.86	1.00															
8 Diversified Arbitrage	0.78	-0.35	0.53	0.91	0.36	0.89	0.77	1.00														
9 Emerging Markets Long/Short Equity	0.80	-0.43	0.73	0.87	0.52	0.85	0.78	0.82	1.00													
10 Equity Market Neutral	0.89	-0.20	0.45	0.80	0.70	0.88	0.71	0.81	0.81	1.00												
11 Europe Long/Short Equity	0.90	-0.32	0.39	0.83	0.74	0.89	0.78	0.79	0.81	0.96	1.00											
12 Event Driven	0.88	-0.44	0.50	0.90	0.53	0.90	0.92	0.87	0.91	0.85	0.90	1.00										
13 Global Long/Short Equity	0.93	-0.39	0.48	0.89	0.64	0.92	0.84	0.85	0.89	0.94	0.96	0.96	1.00									
14 Global Macro	0.78	-0.10	0.40	0.65	0.87	0.74	0.57	0.59	0.69	0.88	0.86	0.71	0.82	1.00								
15 Long/Short Debt	0.84	-0.35	0.46	0.93	0.55	0.97	0.84	0.87	0.86	0.90	0.91	0.90	0.93	0.78	1.00							
16 Merger Arbitrage	0.89	-0.39	0.44	0.83	0.65	0.86	0.68	0.80	0.80	0.93	0.94	0.84	0.93	0.80	0.88	1.00						
17 Multistrategy	0.89	-0.29	0.48	0.87	0.71	0.91	0.79	0.84	0.84	0.97	0.97	0.92	0.97	0.88	0.91	1.00						
18 Systematic Futures	0.42	0.19	0.09	0.09	0.74	0.20	0.14	0.05	0.20	0.49	0.46	0.27	0.40	0.72	0.23	0.37	0.50	1.00				
19 U.S. Long/Short Equity	0.87	-0.45	0.49	0.87	0.50	0.86	0.90	0.85	0.88	0.83	0.87	0.97	0.95	0.68	0.86	0.81	0.90	0.27	1.00			
20 U.S. Small Cap Long/Short Equity	0.88	-0.42	0.49	0.84	0.51	0.84	0.88	0.81	0.88	0.83	0.86	0.96	0.94	0.70	0.85	0.81	0.89	0.31	0.99	1.00		
21 Volatility	0.39	-0.10	0.22	0.52	0.27	0.55	0.26	0.45	0.35	0.54	0.46	0.32	0.47	0.54	0.59	0.56	0.49	0.21	0.31	0.34	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	-0.21	0.02
US OE Currency	0.53	0.46	0.15	-0.04	0.02	0.23
US OE Long/Short Equity	0.96	0.95	0.82	0.13	0.11	0.07
US OE Managed Futures	-0.20	N/A	N/A	-0.42	N/A	N/A
US OE Market Neutral	0.04	0.03	-0.25	0.05	0.02	0.18
US OE Multialternative	0.96	0.95	0.86	0.21	0.19	-0.07
US OE Nontraditional Bond	0.71	0.73	0.58	0.18	0.20	0.34

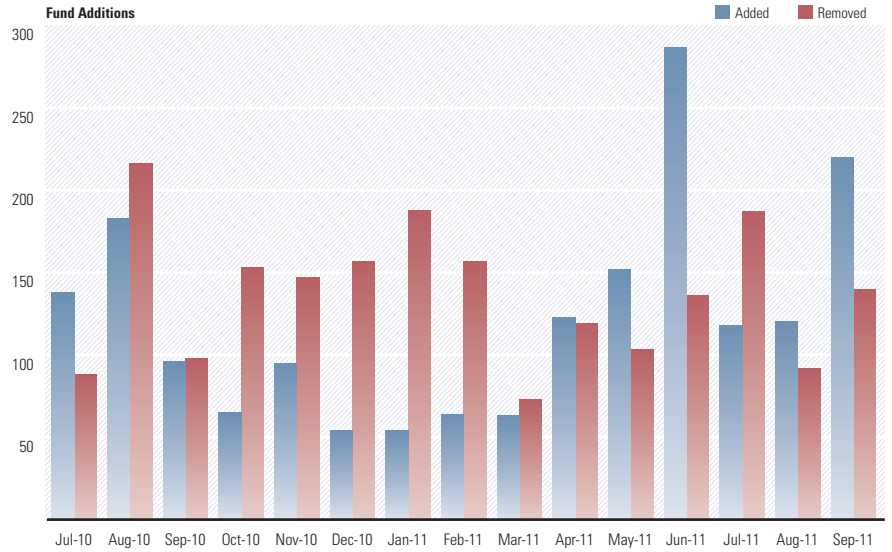
Correlation of Hedge Funds to U.S. Stocks and Bonds	S&P 500 Correlation (USD)			BarCap US Agg Correlation (USD)		
	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
Morningstar MSCI Composite AW	0.78	0.71	0.65	0.08	0.05	0.02
Asia/Pacific Long/Short Equity	0.85	0.80	0.67	0.27	0.24	0.11
Bear Market Equity	-0.52	-0.46	-0.51	-0.09	0.01	0.08
China Long/Short Equity	0.40	0.35	N/A	0.15	-0.01	N/A
Convertible Arbitrage	0.76	0.73	0.64	0.29	0.33	0.22
Currency	0.53	0.43	0.21	0.20	0.14	0.23
Debt Arbitrage	0.80	0.77	0.63	0.30	0.28	0.24
Distressed Securities	0.83	0.80	0.73	0.00	0.03	-0.04
Diversified Arbitrage	0.75	0.67	0.55	0.26	0.28	0.23
Emerging Markets Long/Short Equity	0.80	0.75	0.72	0.21	0.13	0.06
Equity Market Neutral	0.81	0.72	0.56	0.30	0.23	0.20
Europe Long/Short Equity	0.87	0.81	0.71	0.23	0.18	0.11
Event Driven	0.88	0.85	0.78	0.12	0.13	0.05
Global Long/Short Equity	0.91	0.84	0.75	0.23	0.17	0.07
Global Macro	0.66	0.54	0.46	0.36	0.25	0.19
Long/Short Debt	0.82	0.77	0.65	0.36	0.35	0.30
Merger Arbitrage	0.81	0.81	0.73	0.42	0.32	0.20
Multistrategy	0.83	0.77	0.72	0.21	0.20	0.09
Systematic Futures	0.28	0.16	0.03	0.07	0.03	0.20
U.S. Long/Short Equity	0.92	0.90	0.87	0.04	0.04	-0.07
U.S. Small Cap Long/Short Equity	0.91	0.88	0.86	0.04	0.04	-0.09
Volatility	0.38	0.31	0.15	0.54	0.50	0.31



Morningstar Hedge Fund Database Overview as of 09-30-2011

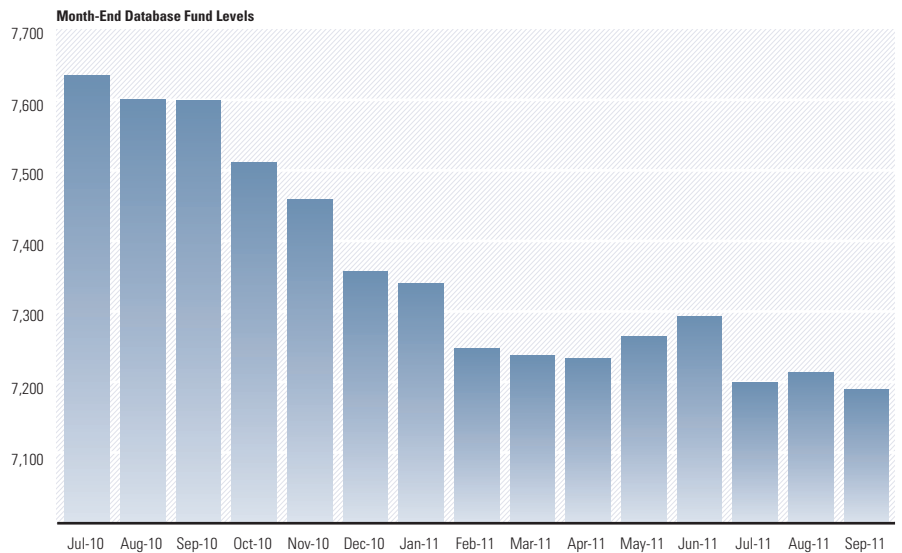
Net Fund Additions by Month

Morningstar's hedge fund database experienced net additions of 39 funds during the third quarter of 2011. The database saw 458 additions and 419 fund withdrawals during the quarter. Funds drop out because they have liquidated or because they cease sharing performance data, typically because of poor performance. Likewise, they may be added because they are new funds or they have recently agreed to supply Morningstar with their data.



Month-End Database Fund Levels

As of Sept. 30, 2011, the Morningstar hedge fund database contained 7,189 funds with performance history and assets-under-management data. This figure includes both single-manager hedge funds and funds of hedge funds, which accounted for approximately 4,600 and 2,600 funds, respectively. As of the end of the third quarter of 2011, the number of funds in the database had dropped approximately 5.8% from July 2010 levels.

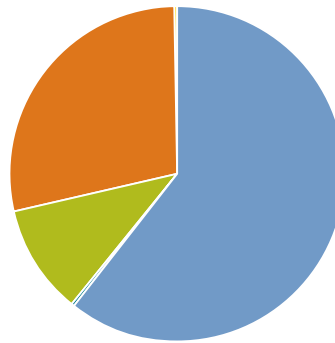


Morningstar Hedge Fund Database Overview as of 09-30-2011

Hedge Funds by Region

Approximately 61% of hedge funds in the Morningstar database are legally domiciled in the North American/Caribbean region, primarily in the United States and the Cayman Islands. A large percentage of U.K. hedge funds are also domiciled in the Cayman Islands for tax and regulatory purposes. Approximately 28% of funds in Morningstar's database are domiciled in Europe, including both European Union and non-EU jurisdictions.

Morningstar Hedge Fund Database by Region



Region	# Funds
N. America/Caribbean	4,356
Africa	30
Asia/Australia	717
Europe	2,048
South America	2
Other	0
Total	7,186

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

Hedge Funds by Location

Approximately 76% 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. France continues to domicile a large portion of European hedge funds after Luxembourg and Ireland. There are surprisingly few hedge funds domiciled in the United Kingdom and Germany in the database.

North America and Surrounding	4,455	Europe	2,048
Cayman Islands	1,815	Luxembourg	717
United States	1,376	Ireland	211
British Virgin Islands	472	France	209
Bermuda	399	Guernsey	138
Canada	206	Switzerland	132
Curacao	48	Italy	110
Bahamas	28	Sweden	92
Panama	6	Malta	83
St. Vincent & the Grenadines	4	Jersey	67
Barbados	1	Netherlands	60
St. Kitts & Nevis	1	Liechtenstein	58
Africa	26	United Kingdom	46
Mauritius	15	Spain	35
South Africa	14	Finland	20
Swaziland	1	Isle of Man	15
Asia and Australia	748	Austria	11
China	680	Denmark	11
Australia	39	Germany	11
Christmas Island	17	Channel Islands	9
Hong Kong	7	Gibraltar	5
Japan	2	Cyprus	3
Singapore	2	Norway	3
Bahrain	1	Belgium	1
Marshall Islands	1	Andorra	1
Vanuatu	1	South America	13
		Brazil	13

Morningstar Hedge Fund Database Overview as of 09-30-2011

Service Providers

Morgan Stanley and Goldman Sachs are the largest prime brokerage-service providers to hedge funds in Morningstar's database, serving a 30% share combined. The big four accounting firms are employed by approximately 72% of the hedge fund database. Citco Fund Services provides administration services to 8.5% of funds in Morningstar's database, significantly more than the next-largest administrator. Maples and Calder, Walkers, and Seward & Kissel are the largest legal-service providers to hedge funds in the database, with a combined 23% market share.

Type	Rank	Service Provider	% of Database
Prime Broker	1	Morgan Stanley	16.28
	2	Goldman Sachs	15.31
	3	UBS	8.60
	4	Deutsche Bank	7.00
	5	Credit Suisse	6.71
	6	J.P. Morgan	6.58
	7	Bank of America/Merrill Lynch	4.94
	8	Newedge	4.53
	9	Citigroup	3.21
	10	BNP Paribas	2.76
Legal Counsel	1	Maples & Calder	10.05
	2	Walkers	7.12
	3	Seward & Kissel	5.99
	4	Dechert	5.78
	5	Elvinger, Hoss & Prussen	4.54
	6	Simmons & Simmons	4.09
	7	Schulte Roth & Zabel	3.80
	8	Sidley & Austin	3.32
	9	Appleby	3.06
	10	Conyers Dill & Pearman	2.72
Auditor	1	Pricewaterhouse Coopers	21.65
	2	KPMG	18.80
	3	Ernst & Young	17.88
	4	Deloitte	13.28
	5	Rothstein Kass	5.89
	6	RSM/McGladery & Pullen	2.84
	7	Grant Thornton	2.48
	8	BDO	2.26
	9	Cabinet Patrick Sellam	1.26
	10	Eisner	1.14
Administrator	1	Citco	8.53
	2	HSBC	4.06
	3	Apex	3.17
	4	Citigroup	3.24
	5	Northern Trust	2.61
	6	CACEIS Fastnet	2.80
	7	CIBC/BNY Mellon	2.37
	8	UBS	2.05
	9	IFS/State Street	1.86
	10	Pictet & Cie (Europe) S.A.	1.53

Alternative Investments Observer

Editor

Nadia Papagiannis, CFA

Contributors

Tim Galbraith; Thomas Idzorek, CFA;
James X. Xiong, Ph.D., CFA; Roger Ibbotson, Ph.D.;
Nadia Papagiannis, CFA; Terry Tian; Mallory Horejs;
Josh Charney; Benjamin N. Alpert, CFA, CAIA

Copy Editors

Thad Doria; Jennifer Ferone Gierat;
Elizabeth Knapik; Elizabeth Romanek

Design

Data Division Design Services

Data Team

Max Salk

Publisher

Scott Burns

Vice President of Research

John Rekenhaller, CFA

Managing Director

Don Phillips

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For inquiries contact: newslettersupport@morningstar.com or nadia.papagiannis@morningstar.com