NEW TOOLS FOR INVESTORS AND ADVISORS:
ALTERNATIVE STRATEGIES IN MUTUAL FUNDS (Part 2)

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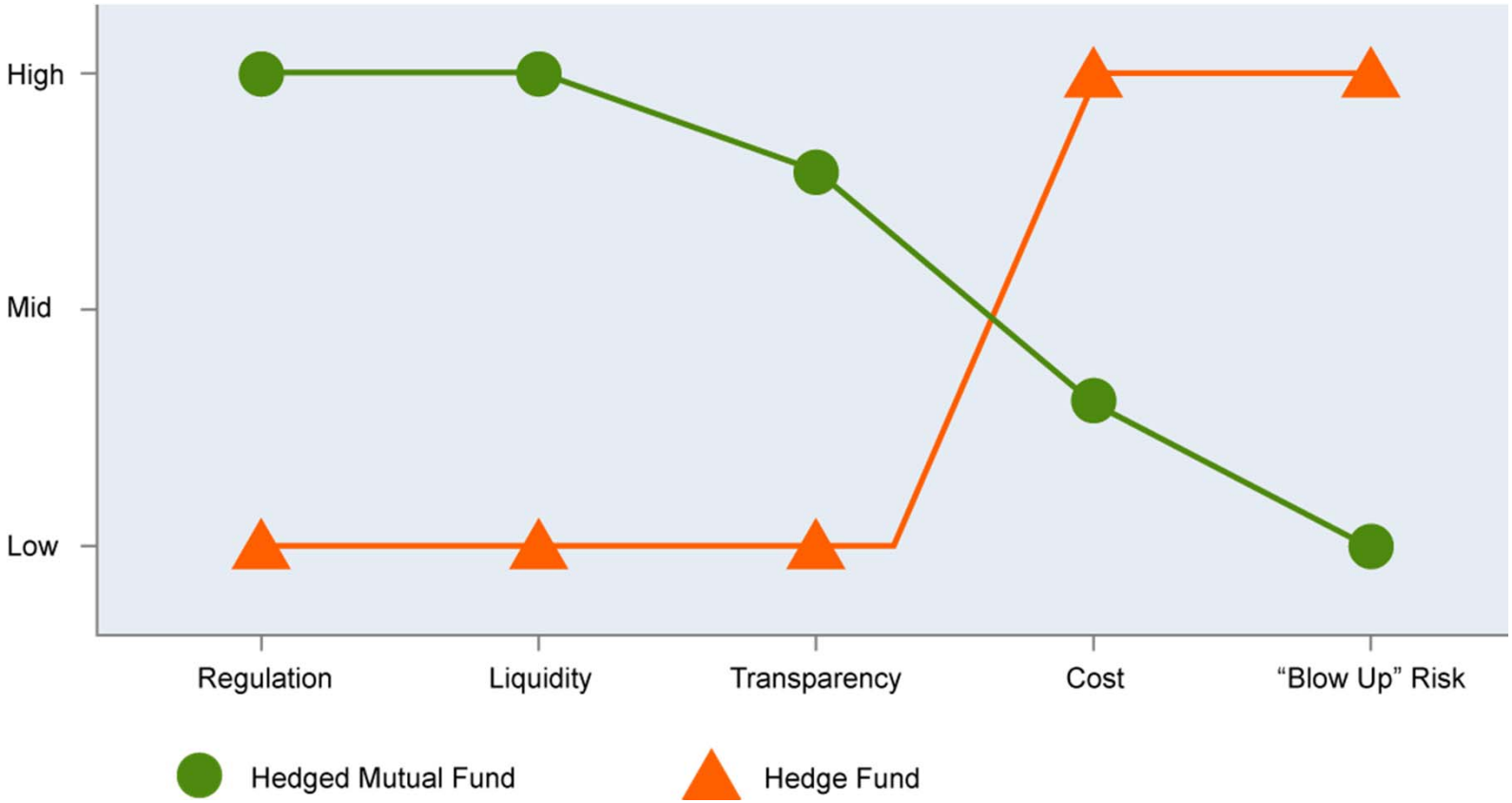
KINDER, GENTLER:
ALTERNATIVE MUTUAL FUNDS VS. HEDGE FUNDS

Alternative mutual funds provide access to alternative strategies with lower costs, more oversight, and better liquidity and transparency than hedge funds.



Source: Lake Partners, Inc.

REGULATORY SAFEGUARDS: ALTERNATIVE MUTUAL FUNDS

Investor protection guides alternatives in ’40 Act structures.

Independent Custody

- Independent bank custodian required
- “Segregated Account” requirement (short sales)
- Tri-party agreement

Limitations on Leverage

- “Senior Securities” rule (as interpreted)
- 3:1 Asset coverage, or full collateral
- Implicit limitations on derivatives (see “ten-triple-six”)

Liquidity & Daily Pricing

- Requirement for daily, “fair” pricing (FASB 157, etc.)
- 15% maximum illiquid securities
- Limited use of illiquid securities in face of daily liquidity

Lower Costs

- Restrictions on incentive fees

EXPLANATORY NOTES AND DISCLOSURES

The S&P 500 is an unmanaged, capitalization-weighted index of the common stocks of 500 widely held U.S. companies. It does not include fees or expenses. Direct investment in an index is not possible. (S&P 500 is a registered trademark of The McGraw-Hill Companies, Inc.) LASSO differs substantially from the S&P 500, which is used for comparison purposes as a widely recognized measure of U.S. stock market performance. While the returns of LASSO are somewhat correlated to the index, LASSO through its underlying funds may invest in different stocks and in different proportions than in the index.

The Barclays Capital US Aggregate Bond Index is an unmanaged index of fixed rate debt securities rated investment grade or higher by Moody's, Standard & Poor's, or Fitch rating services. All issues have at least one year to maturity and an outstanding par value of at least $100 million. It does not include fees or expenses. Direct investment in an index is not possible. (The index is a registered trademark of Barclays Capital PLC.) LASSO differs substantially from this index, which is used for comparison purposes as a widely recognized measure of U.S. bond market performance. Although the mutual funds in the LASSO portfolio emphasize stocks and hedged equities, and bonds to a lesser degree, the historical volatility of LASSO (as measured by standard deviation, a measure of the variation of returns) is more comparable to the bond market index rather than the stock market index. LASSO may use underlying funds that invest in non-investment grade bonds, which may entail additional credit risk.

The 60% S&P 500/40% BC Aggregate hybrid index, calculated from the two indices above, is a widely used comparison for balanced strategies utilizing a mix of stocks and bonds. Direct investment in an index is not possible. Although the LASSO strategy may invest in stocks and bonds, LASSO differs substantially from the hybrid index. LASSO and its underlying funds may invest in different stocks and bonds and in different proportions than in the hybrid index. • The hypothetical asset allocation (on page 52) reflecting investment in LASSO and varying proportions of a hybrid balanced 60/40 portfolio is for illustration only and does not represent actual or future performance of any portfolio mix. The performance and volatility of the hypothetical asset allocation presumes investment for thirteen years beginning at the inception of the LASSO strategy on December 31, 1998. Investment on any other date would cause different results. The hypothetical performance figures were affected by material market and economic conditions that were independent of and not controlled by Lake Partners, Inc. or the managers of the underlying funds and may be different in the future. The hypothetical asset allocation illustration assumes that there would not have been any additional cash balances, except as held within the LASSO strategy or the underlying funds, and that there would be no additional fees, which would have reduced returns.

EXPLANATORY NOTES AND DISCLOSURES

HFRX Equity Hedge Index ("HFRXEH") is part of the HFRX series of hedge fund indices, published by Hedge Fund Research, Inc., which are designed to reflect the *daily* performance of a variety of hedge fund strategies. The indices include funds that meet the screening criteria of Hedge Fund Research, Inc., including a 24-month track record, $50 million under management, and are open to new investments. The HFRXEH is designed to be both investable and to reflect the overall structure and composition of the equity long/short hedge fund universe. • LASSO differs substantially from the HFRXEH, which is used for comparison purposes as a daily-valued measure of hedge fund performance. LASSO is comprised of "alternative mutual funds," a limited universe of mutual funds that use short-selling, hedging and other hedge-fund-like strategies. In contrast, the HFRXEH uses a sampling from the broad equity long/short hedge fund universe, which contains more funds and strategies than available through alternative mutual funds. In addition, hedge funds in the index may also use a greater degree of leverage and illiquid securities than permitted for mutual funds. Nevertheless, the performance of LASSO and the HFRXEH have exhibited a significant level of correlation, reflecting the emphasis of long-short equity strategies in the universe of hedged mutual funds. • The index is net of fees and expenses of the underlying managers, including incentive fees, a type of fee generally not charged by the mutual funds in LASSO due to regulatory restrictions. The index does not reflect a "fund-of-funds" management fee, which is reflected in LASSO performance. Direct investment in the index is not possible. Commingled vehicles based on the index are available to investors, subject to additional fees and expenses.

HFRI Fund of Funds Composite Index ("HFRIFOF"), published by Hedge Fund Research, Inc., is an equal weighted composite of a broad range of funds of funds investing in hedge funds. The HFRIFOF includes funds that meet the screening criteria of Hedge Fund Research, Inc., including $50 million under management or a track record longer than 12 months. As of December 2011, the HFRIFOF includes over 650 underlying domestic and offshore hedge funds of funds. Performance is calculated monthly, net of all fees. (Underlying hedge funds of funds may or may not include side pocket investments in performance calculations.) Trailing four months of performance are subject to revision. The HFRIFOF is not an investable index. • LASSO differs substantially from the HFRIFOF, which is used for comparison purposes as a measure of performance for hedge funds of funds. LASSO is comprised of "alternative mutual funds," a limited universe of mutual funds that use short-selling, hedging and other hedge-fund-like strategies. In contrast, the HFRIFOF uses a sampling from the broad hedge funds of funds universe, which contains more funds and strategies than available through alternative mutual funds. In addition, index constituents and their underlying funds may use a greater degree of leverage and illiquid securities than permitted for mutual funds. • The index is net of fees and expenses of underlying funds, including incentive fees, a type of fee generally not charged by the mutual funds in LASSO due to regulatory restrictions. Direct investment in the index is not possible.

EXPLANATORY NOTES AND DISCLOSURES

Due to the growth in the number and variety of alternative mutual funds, Morningstar eliminated its prior, broadly inclusive Long-Short Category, and created new, more differentiated alternative categories in 2010 and 2011. The Morningstar Alternative Category Averages ("MACAs") are among the various averages published by Morningstar, Inc. to measure the performance of a group of funds that utilize a similar investment strategy. Data herein are based on Morningstar's Enhanced Category Averages methodology, which reflects the average monthly returns for each category, based on all funds that existed during each historical month, with annual and trailing return calculated by geometrically linking these monthly numbers. The MACAs are designed to reflect the average performance of mutual funds utilizing similar alternative investment strategies. The MACAs created in 2010 and 2011 are described below • LASSO differs substantially from the MACAs, which are used for comparison purposes as a measure of alternative mutual fund performance. The LASSO portfolio may include mutual funds included or not included in the MACAs. • The MACAs are net of fees and expenses of the underlying managers. The MACAs do not reflect a "fund-of-funds" management fee, which is reflected in LASSO performance. Direct investment in the MACAs are not possible.

Long-Short Equity Category. Long-short equity funds take long positions in securities that appear attractive and short positions in securities that appear to be unattractive. Some of these funds use bottom-up research to determine long or short positions. Other funds in this category may hedge equity exposure through ETFs or derivatives. Gross short exposure is generally greater than 20%.

Multialternative Category. These funds offer investors exposure to several different alternative investment strategies. Funds in this category allocate a majority of their assets to alternative strategies. Funds in this category include both funds with static allocations to alternative strategies and funds tactically allocating among alternative strategies and asset classes. Gross short exposure is generally greater than 20%.

Managed Futures Category. These funds primarily trade liquid global futures, options, swaps, and foreign exchange contracts, both listed and over-the-counter. A majority of these funds utilize trend-following, price-momentum strategies. Other strategies included in this category are systematic mean reversion, discretionary global macro, commodity index tracking, and other futures strategies. More than 60% of a fund's exposure is invested through derivative securities. These funds obtain exposure primarily through derivatives; the holdings are largely cash instruments.

Market Neutral Category. These funds attempt to hedge out all market exposure by taking offsetting long and short positions. Strategies in this category may include equity market neutral, merger arbitrage, convertible arbitrage and similar strategies. Funds included are often managed as beta-neutral, dollar-neutral, or sector-neutral. A distinguishing feature of funds in this category is that they typically have low beta exposures (< 0.3 in absolute value) to major market indexes such as MSCI World. To reduce systematic risk, these funds put the emphasis on issue selection, with profits dependent on their ability to sell short and buy long the correct securities.

For more information -

Aston Investment Advisor Services: 800.597.9704
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