ASTON/River Road Long-Short (ARLSX) – June 2012

A Mutual Fund Observer "Most Intriguing New Fund"

Objective and Strategy

ARLSX seeks to provide absolute returns ("equity-like returns," they say) while minimizing volatility over a full market cycle. The Fund invests, long and short, mostly in US common stocks but can also take positions in foreign stock, preferred stock, convertible securities, REITs, ETFs, MLPs and various derivatives. The Fund is not "market neutral" and will generally be "net long," which is to say it will have more long exposure than short exposure. The managers have a strict, quantitative risk-management discipline that will force them to reduce equity exposure under certain market conditions.

Adviser

Aston Asset Management, LP, which is based in Chicago. Aston's primary task is designing funds, then selecting and monitoring outside management teams for those funds. As of March 31, 2012, Aston has partnered with 18 subadvisers to manage 26 mutual funds with total net assets of approximately $10.7 billion. Aston Funds are available to retail investors, as well as through various professional channels.

Managers

Matt Moran and Daniel Johnson. Both work for River Road Asset Management, which is based in Louisville. They manage money for a variety of private clients (cities, unions, corporations and foundations) and sub-advise five funds for Aston, including the now-closed ASTON / River Road Independent Value Fund (ARIVX). River Road employs 39 associates including 15 investment professionals. Mr. Moran, the lead manager, joined River Road in 2007, has about a decade's worth of experience and is a CFA. Before joining River Road, he was an equity analyst for Morningstar (2005-06) and an associate at Citigroup (2001-05), and an analyst at Goldman Sachs (2000-2001). His MBA is from the University of Chicago. Mr. Johnson earned his Masters of Accountancy from the University of Kentucky and is a CPA and a CFA. Before joining River Road in 2006, he worked at PricewaterhouseCoopers.

Management's Stake in the Fund

Mr. Moran and Mr. Johnson each had between $100,000 and $500,000 as of April 30, 2012. Those investments represent a significant portion of the managers' liquid net worth.

Opening Date

May 4, 2011.

Minimum Investment

$2,500 for regular accounts and $500 for retirement accounts.

Expense Ratio

2.75%, after waivers, on assets of $5.5 million. The Fund's operating expenses are capped at 1.70%, but expenses related to shorting add another 1.05%. Expenses of operating the Fund, before waivers, are 8.7%.

Comments

Long/short investing makes great sense in theory but, far too often, it's dreadful in practice. After a year, ARLSX seems to be getting it right and its managers have a pretty cogent explanation for why that will continue to be the case.

Here's the theory: in the long term, the stock market rises and so it's wise to be invested in it. In the short term, it can be horrifyingly irrational and so it's wise to buffer your exposure. That is, you want an investment that is hedged against market volatility but that still participates in market growth.

River Road pursues that ideal through three separate disciplines: long stock selection, short stock selection and level of net market exposure.

In ***long stock selection***, their mantra is "excellent companies trading at compelling prices." Between 50% and 100% of the portfolio is invested long in 15-30 stocks.

> For training and other internal purposes, River Road's analysts are responsible for creating and monitoring a "best ideas" pool, and Mr. Moran estimates that 60-90% of his long exposure overlaps that pool. They start with conventional screens to identify a pool of attractive stocks. Within their working universe of 200-300 such stocks, they look for fundamentally attractive companies (those with understandable businesses, good management, clean balance sheets and so on) priced at a discount from their absolute value. They allow themselves to own the 15-30 most attractive names in that universe.

In ***short stock selection***, they target "challenged business models with high valuations and low momentum." In this, they differ sharply from many of their competitors. They are looking to bet against fundamentally bad companies, not against good companies whose stock is temporarily overpriced. They can be short with 10-90% of the portfolio and typically have 20-40 short positions.

> Their short universe is the mirror of the long universe: lousy businesses (unattractive business models, dunderheaded management, a history of poor capital allocation, and favorites of Wall Street analysts) priced at a premium to absolute value.

Finally, they control ***net market exposure***, that is, the extent to which they are exposed to the stock market's gyrations. Normally the Fund is 50-70% net long, though exposure could range from 10-90%.

> The managers have a "drawdown plan" in place which forces them to become more conservative in the face of sharp market declines. While they are normally 50-70% long, if their portfolio has dropped by 4% they must reduce net market exposure to no more than 50%. A 6% portfolio decline forces them down to 30% market exposure and an 8% portfolio decline forces them to 10% market exposure. They achieve the reduced exposure by shorting the S&P500 via the SPY exchange-traded fund; they do not dump portfolio securities just to adjust exposure. They cannot increase their exposure again until the Russell 3000's 50 day moving average is positive. Only after 10 consecutive positive days can they exit the drawdown plan altogether.

Mr. Moran embraces Benjamin Graham's argument that "The essence of investment management is the management of risks, not the management of returns." As a result, they've built in a series of unambiguous risk-management measures. These include:

- A prohibition on averaging down or doubling-down on falling stocks
- Stop loss orders on every long and short position
- A requirement that they begin selling losing positions when losses develop
- A prohibition on shorting stocks that show strong, positive momentum regardless of

how ridiculous the stock might otherwise be

- A requirement to systematically reduce any short position when the stock shows positive momentum for five days, and
- The market-exposure controls embedded in the drawdown plan.

The Fund's early results are excellent. Over its first full year of existence, the Fund returned 3.7%; the S&P500 returned 3.8% while the average long-short fund lost 3.5%. That placed the Fund in the top 10% of its category. The Fund's risk-management measures are striking. Its maximum drawdown (the drop from a previous high) was substantially smaller than its peers, it captured less of the market's downside and more of its upside. It also substantially eased the pain on the market's worst days. The Russell 3000, a total stock market index, lost an average of 3.6% on its fifteen worst days between the Fund's inception and the end of March, 2012. On those same 15 days, River Road lost 0.9% on average – which is to say, its investors dodged 75% of the pain on the market's worst days.

This sort of portfolio strategy is expensive. A long-short fund's expenses come in the form of those it can control (fees paid to management) and those it cannot (expenses such as repayment of dividends generated by its short positions). At 2.75%, the fund is not cheap but the controllable fee, 1.7% after waivers, is well below the charges set by its average peer. With the adviser absorbing another 6% in expenses as a result of waivers, it's probably unreasonable to ask for lower.

Bottom Line

Long-term investors need exposure to the stock market; no other asset class offers the same potential for long-term real returns. But combatting our human impulse to flee at the worst possible moment requires buffering that exposure. With the deteriorating attractiveness of the traditional buffer (bonds), investors need to consider non-traditional ones. There are few successful, time-tested funds available to retail investors. Among the crop of newer offerings, few are more sensibly-constructed or carefully managed than ARLSX seems to be. It deserves attention.

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Performance and Disclosure

	Annualized Total Returns		
as of June 30, 2013	One Year	Since Inception	Inception Date
ASTON/River Road Long-Short Fund - N Class	12.43%	7.70%	5/04/11
ASTON/River Road Long-Short Fund – I Class	-	1.64%^	3/4/13
Russell 3000 Index	21.46%	9.80%	5/01/11
S&P 500 Index	20.58%	10.27%	5/01/11

^ Total Return

The performance data quoted represents past performance. Past performance is no guarantee of future results. Investment return and principal value will fluctuate so that an investor's shares, upon redemption, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For performance data current to the most recent month-end, please visit our website at www.astonfunds.com. The Fund's gross expense ratio is 5.08% and 4.83% for the N and I class respectively. The net expense ratio excluding dividend & interest expenses on short sales and acquired fund fees is 1.70% and 1.45% for the N and I class respectively. The total operating expenses are 3.16% and 2.91% for the N and I class respectively. Net expenses do not include dividend and interest expense on short sales of 1.41% and acquired fund fees of 0.05%. The Advisor is contractually obligated to waive management fee and/or reimburse ordinary expenses through February 28. 2014. The total operating expense includes dividend and interest expense on short sales and acquired fund fees, which are not included in the net expense ratio.

The **Russell 3000 Index** is capitalization-weighted index of the 3,000 largest U.S. companies, representing approximately 98% of the investable U.S. equity market. The **S&P Index** is an unmanaged index of 500 widely traded industrial, transportation, financial and public utility stocks.

As of June 30, 2013 the **Morningstar® Ranking** for N class shares is 30th of 218 funds in the Long/Short Equity Category, based on Total Returns.

The highest or most favorable Morningstar percentile rank is 1 and the lowest percentile rank is 100. The top-performing fund in a category will always receive a rank of 1. Various rating agencies categorize funds differently. Past performance is no guarantee of future results.

Note: Short sales may involve the risk that the fund will incur a loss by subsequently buying a security at a higher price than the price at which the fund previously sold the security short. A loss incurred on a short sale results from increases in the value of the security, losses on a short sale are theoretically unlimited. Value investing often involves buying the stocks of companies that are currently out of favor that may decline further. Investing in exchange traded and closed end funds are subject to additional risk that shares of the underlying fund may trade at a premium or discount to their net asset value per share. Convertible preferred securities are subject to the risks of equity securities and fixed income securities. Derivatives can be highly volatile and involve risk in addition to the risk of the underlying reference security. Investing in the securities of foreign issuers involves special risks and considerations not typically associated with investing in U.S. companies.

Parameters set by the Subadviser are not a fundamental policy of the Fund and are subject to change at any time.

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