Litman Gregory Masters Alt Strats Instl MASFX

A cut above other multialternative funds.

Morningstar's Take MASFX

Morningstar Rating	★★★★
Morningstar Analyst Rating	Bronze

Morningstar Pillars

Process	Positive
Performance	Neutral
People	Positive
Parent	Positive
Price	Neutral

Role In Portfolio
Supporting

Fund Performance MASFX

Year	Total Return (%)	+/- Category
YTD	2.01	0.14
2014	3.58	1.77
2013	6.32	2.16
2012	9.41	5.55
2011	n/a	n/a

Data through 3-31-15

4-02-15 | by Jason Kephart

Litman Gregory Masters Alternative Strategies' strong cast of subadvisors has helped it stand out in the multialternative Morningstar Category and earn a Morningstar Analyst Rating of Bronze.

This fund of alternative strategies is built to be a replacement for a roughly equal mix of stocks and bonds in a traditional portfolio but with a low correlation to long-only asset classes. As such, it aims to deliver performance similar to a 40/60 benchmark of stocks and bonds over a full market cycle by allocating about half the portfolio to alternative strategies with bondlike exposure and half to more equity-sensitive strategies.

Portfolio manager Jeremy DeGroot and the manager research team at Litman Gregory look for subadvisors that are comfortable running high-conviction strategies and can pass their due-diligence process, which includes multiple on-site visits, interviews, and a test portfolio. Finally, each subadvisor's strategy must have a low correlation to the existing strategies in the fund. On the bond side, that's led to equal 25% allocations to a global unconstrained-bond strategy run by Loomis Sayles and an opportunistic mortgage-backed security strategy run by DoubleLine Capital. The equity sleeve is predominately divvied up between an absolute return strategy run by First Pacific Advisors and a merger-arbitrage strategy run by Water Island Capital (20% each), with a newer 10% allocation to a long-short equity strategy run by Passport Capital. Three of the five strategies are similar to what the subadvisors are running in separate mutual funds, like Gold-rated FPA Crescent FPACX. Those managers all have Positive People scores, an indication of superior manager talent and resources.

The diversification achieved through the allocation process has paid off. Only twice since the fund launched in 2011 have two subadvisors lost money in the same quarter. Moreover, the fund has produced the best Sharpe ratio in the category and annualized returns of 8.50% that top 85% of peers from inception through February.

Although fees could be lower, this fund is a solid choice.

Process Pillar Positive | Jason Kephart 04/02/2015

Litman Gregory's six-person manager research team is responsible for selecting and monitoring the underlying managers and for the fund's allocation to each manager. The fund's portfolio is designed to replace an equal portion of stocks and bonds from a traditional portfolio. For that reason, the fund's benchmark is 40% stocks and 60% bonds. Management targets a volatility range of between 4% and 8% annualized standard deviation.

For this fund, the manager research team looks for subadvisors that are comfortable running high-conviction strategies, usually best-ideas portfolios, and have a demonstrated an orientation toward preserving capital. The team also looks for strategies with a low correlation to each other. Each subadvisor must pass a due-diligence screening (which includes multiple on-site visits, interviews, and portfolio stress tests). Before a subadvisor can be added to the portfolio, it must also be approved by the manager research team. An analyst is assigned to each subadvisor and must make the case to the overall team.

The fund's allocation to subadvisors is based on their correlation to each other and their expected equity market beta. For example, Passport Capital, which was added in late 2014, runs a long-short equity strategy that is expected to have a higher sensitivity to equity markets than the other strategies. As a result, it only has a 10% weighting in the fund.

This fund launched in September 2011 with four subadvisors and added a fifth in the fourth quarter of 2014. Its strategic asset allocation is close to its moderately conservative benchmark, with 50% in bond-related alternative strategies and 50% in alternative strategies with exposure to equities.

The subadvisors generally run concentrated versions of strategies that they are managing in other vehicles. The Loomis Sayles absolute return bond team, for example, is running a more concentrated version of Neutral-rated Loomis Sayles Strategic Alpha LASYX. In this fund, it has a 28% allocation to high-yield bonds, 10 percentage points higher than the stand-alone mutual fund as of the end of the year. FPA runs an absolute return strategy that relies heavily on cash (it had a 42% stake as of Dec. 31, 2014) to manage equity market risk. It can allocate more to small caps and illiquid investments in this fund than in Gold-rated FPA Crescent. Water Island's portfolio focuses on its 20 best merger-arbitrage ideas, compared with the 50 or more deals in its Bronze-rated Arbitrage ARBNX.

DoubeLine runs an opportunistic mortgage-backed security strategy that manager Jeffrey Gundlach has run in a hedge fund since 1991, while he was with his former firm TCW. Passport's long-short equity strategy blends a mix of macro views and fundamental company research.

Performance Pillar Neutral | Jason Kephart
04/02/2015
This fund has been a standout performer. Since it launched in the fall of 2011, the fund has returned 8.34% annualized, better than 85% of peers, and its 2.21 Sharpe ratio is the best in the category from inception through Jan. 31, 2015. It also compares favorably with the Morningstar Moderately Conservative Index, a 40% stock and 60% bond index analogous to the fund's benchmark, which has returned 9.43% annualized with a 1.57 Sharpe ratio.

Management's decision to overweight its allocation to the DoubleLine opportunistic income strategy from late 2011 through the third quarter of 2013 proved fruitful as the strategy's return topped 7% in both the first and third quarters of 2012.

The mix of strategies has helped keep returns steady as well. Only twice have two strategies lost money in the same quarter since the fund launched. This was notably on display during the second quarter of 2013, when interest rates unexpectedly rose. The DoubleLine and Loomis Sayles bond strategies suffered losses (1.1% and 2.6%, respectively), but those were offset by gains from FPA (2.7%) and Water Island (1.1%). The fund's 0.18% loss in the quarter was much better than the category's 1.81% loss.

The addition of a long-short equity strategy may affect the fund's equity sensitivity (which has been in line with the category norm), but the 10% allocation at this time should limit its effects.

People Pillar Positive | Jason Kephart
04/02/2015
Litman Gregory has assembled a strong group of managers to run this fund.

Jeremy DeGroot, chief investment officer, leads the six-person manager research and due-diligence team at Litman Gregory. The team oversees the manager selection, manager allocation, and ongoing monitoring of each subadvisor. Individual analysts are assigned to each subadvisor for monitoring and are also tasked with searching for new managers. Before new subadvisors can be added to a portfolio, the analyst assigned to them must make a case to the research team, which ultimately has to agree before a subadvisor can be added. DeGroot has between $100,001 and $500,000 invested in the fund, below best-practice levels but still a positive sign of management's alignment with shareholders.

This fund's People score is greatly boosted by the expertise of its subadvisors. Matt Eagan, Todd Vandam, and Kevin Kearns of Loomis Sayles, Steven Romick of First Pacific Advisors, and the team at Water Island Capital are all veteran managers who have successfully run similar strategies in their own funds. Jeffrey Gundlach had a long and storied career investing in mortgage-backed securities at TCW before founding DoubleLine in 2010.

John Burbank and Tim Garry of Passport Capital were added to the fund in the fourth quarter of 2014. Passport has been running a long-short hedge fund since 2010.

Parent Pillar Positive | Jason Kephart
11/18/2014
Litman Gregory has been a fine steward. Since it first rolled out mutual funds 18 years ago, the firm has stuck with its philosophy, adding a limited number of funds run by groups of proven subadvisors that each contribute a small number of their best ideas to the portfolios. (There are four funds in all, including Litman Gregory Masters Alternative Strategies.) The firm has also kept some key funds small and flexible--the Equity and International funds both closed to new investors in the past at under $1 billion in assets (although both are now open, and the latter is at $1.5 billion). Limiting fund sizes has allowed the firm to keep the number of subadvisors at each fund to a manageable number, rather than adding ever more and winding up with sprawling, bland portfolios.

The funds fall short in terms of manager investment, although they still look better than most subadvised funds. Two subadvisors (out of a total of 19 across the funds) invest more than $1 million in a fund, one has between $500,000 and $1 million in a fund, and nine others (including the two principals from Litman Gregory) have $100,000 to $500,000 invested in at least one fund. And on the fee front, most of the funds look pricey. Alternative Strategies is an exception: The expense ratio of its Institutional shares is below average compared with other multialternative funds.

Price Pillar Neutral | Jason Kephart
04/02/2015
This fund is offered in two share classes. The bulk of assets (85%) are in the fund's Institutional share class, which has an annual report net expense ratio of 1.49%. It's cheaper than most multimanager funds in the multialternative category, which charge closer to 2.00%, but just average compared with all alternative funds. The Investor share class charges 1.74%, still cheaper than the multialternative category average, but above average compared with all alternative funds. The fund's management fee of 1.40% is above the 1.10% average charged by peers.