

Litman Gregory Masters Alt Strats Instl MASFX

Strong subadvisors give this fund an edge.

Morningstar's Take MASFX

Morningstar Rating ★★★★★

Morningstar Analyst Rating Bronze

Morningstar Pillars

Process	+	Positive
Performance	+	Positive
People	+	Positive
Parent	+	Positive
Price	○	Neutral

Role In Portfolio

Supporting

Fund Performance MASFX

Year	Total Return (%)	+/- Category
YTD	1.24	-0.39
2016	6.87	5.49
2015	-0.77	1.81
2014	3.58	1.77
2013	6.32	2.16

Data through 3-31-17

4-06-17 | by Jason Kephart

Litman Gregory Masters Alternative Strategies is underpinned by a strong cast of subadvisors and a management team that doesn't get in their way. Although fees could be cheaper, this remains one of the best choices in the multialternative Morningstar Category. Its Morningstar Analyst Rating remains Bronze.

Portfolio manager Jeremy DeGroot and the manager research team at Litman Gregory look for subadvisors that are comfortable running high-conviction strategies. For this multistrategy alternative fund, they've selected five managers that run strategies with historically low correlations to one another and to traditional equities and bonds. They've done a good job selecting managers; four of the five strategies are similar to what the subadvisors are running in separate mutual funds, like Gold-rated FPA Crescent FPACX. Those four funds all receive Positive People ratings from us, an indication of superior manager talent and resources.

DeGroot and team don't make top-down allocation shifts, which have tripped up many peers in the category. Instead, management's high conviction in each manager's ability to meet or exceed its objectives—which are generally positive absolute returns regardless of the direction of equity or bond markets—results in a roughly equal weighting to each of the four main subadvisors. The hands-off approach has led to strong results thus far. Its five- and three-year annualized returns rank in the top quintile of multialternative funds.

The fund has a notable warning sign: Its heavy reliance on nontraditional bond strategies, which make up 50% of assets, has led to a high correlation to high-yield bonds. The fund's 0.87 correlation to the BofAML U.S. High Yield Master II Index, an index of below-investment-grade bonds, from 2014 through the end of March 2017 was one of the highest in the multialternative category; investors here are often exposed to a fair dose of credit risk.

Still, this fund remains a standout choice in the category for its access to a solid mix of diversified strategies run by proven managers.

Process Pillar + Positive | Jason Kephart 04/06/2017

This fund targets an absolute return of between 4% to 8% with similar annualized volatility over a full market cycle. Litman Gregory's manager research process has proved it can identify top-flight managers across multiple mandates to meet that goal. And the firm's aversion to trying to time strategies means that subadvisors' results won't be waylaid by notoriously difficult-to-execute tactical decisions at the fund level. These considerations drive the fund's Positive Process rating.

Litman Gregory's six-person manager research team selects and monitors the fund's underlying managers, and it also determines the fund's

allocation to each manager. For this fund, the manager research team looks for subadvisors that are comfortable running high-conviction strategies, usually best-ideas portfolios, and have demonstrated an orientation toward preserving capital. The team also looks for strategies with a low correlation to each other.

Management maintains a strategic, roughly equal-weight allocation to its four core subadvisors. It believes each manager has an equally good chance of meeting or exceeding its expected return target. (A fifth noncore subadvisor has 10% of the portfolio.) Timing strategies is a difficult exercise, so taking that out of the process should lead to smoother returns over time relative to funds that switch strategies more actively.

Management intends for the fund to be a diversifier for a traditional balanced fund, which led to an equal split between alternative bond and equity strategies. Loomis Sayles and DoubleLine each manage 25% allocations, Water Island and First Pacific Advisors each manage 20%, and Passport Capital manages 10%.

The subadvisors generally run concentrated versions of strategies that they manage in other vehicles. Water Island's portfolio, for example, focuses on its 20 best merger-arbitrage ideas, compared with the 50 or more deals in its Bronze-rated Arbitrage ARBNX. The Loomis Sayles absolute return bond team can take on more risk in this fund than in Neutral-rated Loomis Sayles Strategic Alpha LASYSX. At the end of 2015, for example, the team had a 29% allocation to high-yield bonds, 12 percentage points higher than the mutual fund. As high-yield bonds rallied in 2016, it removed much of that overweighting. FPA runs an absolute return strategy. It can allocate more to small caps and illiquid investments in this fund than in FPA Crescent.

DoubleLine 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. The strategy typically holds 40-70 stocks long and 10-25 stocks short.

Performance Pillar + Positive | Jason Kephart
04/06/2017

This fund targets returns of Libor plus 4% to 8% with a similar level of volatility. Since its inception in September 2011, the fund's annualized returns of 5.4% fall within its target range and trounce the category norm of 1.7%. Its risk-adjusted returns, measured by Sharpe and Sortino ratios, are also well above most peers. The strong results have led to us upgrade its Performance rating to Positive from Neutral.

The subadvisors have done a good job of balancing each other out. The third quarter of 2015 is the only quarter since the fund launched where four of the five subadvisors lost money at the same time. Loomis Sayles and FPA both stumbled in the quarter, losing 3.5% and 5.2%, respectively, thanks to bets on energy equities and credits. The energy bet paid off for both managers in 2016, though, as oil recovered in the second and third quarters. Loomis gained 5% in the second quarter, and FPA gained 5% in the third quarter. The strong performance of the two helped push the fund to a 6.8% return for the year, topping 90% of peers.

While the fund's returns have been above average, it has fallen short as a diversifier. Since its inception, its average three-year rolling correlation to the BofAML U.S. High Yield Master II Index, an index of below-investment-grade bonds, is 0.87. Investors should keep its correlation to risk assets in mind when allocating to the fund.

People Pillar + Positive | Jason Kephart
04/06/2017

Litman Gregory's proven manager research team has assembled a strong group of managers to run this fund, earning it a Positive People rating.

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. Before new subadvisors can be added to a portfolio, the analyst assigned to them must make a case to the research team, and all members must agree before a subadvisor can be added.

This fund's People rating is boosted by 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 storied career investing in mortgage-backed securities at TCW before founding DoubleLine in 2010, and the strategy he runs here relies heavily on that background.

Tim Garry, former head of risk management at Passport Capital, is the only departure among the subadvisors since the fund launched. He left the firm in late 2015. Founder John Burbank remains, though, and Litman Gregory is confident that the risk management process Garry established won't be compromised by his exit.

Parent Pillar + Positive | Jason Kephart
03/28/2017

Litman Gregory has been a fine steward. Since it first rolled out mutual funds 20 years ago, the firm has stuck with its process of choosing high-quality managers to subadvise mutual funds. The firm offers a limited number of funds run by proven subadvisors that each contribute a small number of their best ideas to the portfolios. As of March 2017, Litman offers four mutual funds, and it expects to add one more this year. It will be the first new launch since 2011. 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 \$1.1 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 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 20 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. On the fee front, most of the funds look pricey. Still, the quality of the underlying managers has helped the lineup stand out. Two funds earn Morningstar Analyst Ratings of Bronze.

Price Pillar ● Neutral | Jason Kephart
04/06/2017

This fund is offered in two share classes. The bulk of assets (90%) are in the fund's institutional share class, which has an annual report net expense ratio of 1.47%. 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 fund earns a Neutral rating for Price. The Investor share class charges 1.74%.